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EXCHANGE CONTROL IN CENTRAL EUROPE

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To
HERMINE AND DOROTHY

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HOWARD S. ELLIS.

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EXCHANGE CONTROL IN
CENTRAL EUROPE

CHAPTER I

THE NATURE OF EXCHANGE CONTROL¹

MAIN TYPES OF EXCHANGE CONTROL

In a broad sense of the term, exchange control embraces all measures directed toward stabilizing the market in foreign exchange. These measures may be divided into five major types and arranged in order of their severity, that is, according to their departure from the character of a "liberal" international system wherein payments are free. Of these five types, the first represents authoritarian interference in so mild a form as scarcely to be regarded as exchange control in its ordinary connotation. Directed toward neither the prevention of genuinely "economic" capital movements nor the maintenance of exchange rates at other than ultimate equilibrium levels, this control aims merely to eliminate speculative activity and sharp variations in rates. Measures of this sort may or may not involve monopolizing of *devisen*² transactions with a state authority, and they may be transitory or permanent. Both the pound and dollar devaluations in 1931 and 1933 were accompanied by temporary centralization of exchange dealings in official hands, coupled with understandings between the banks and the Treasuries that foreign bills for speculative purposes would not be forthcoming.³ To protect monetary standards from sudden turns of either appreciation or depreciation, national monetary authorities have also established more or less permanent systems, ranging from the pre-war *Devisenpolitik* practiced by the imperial Austro-Hungarian and the Russian central banks to the British, French, and American equalization accounts. With these systems of mere stabilization against short-run movements we shall not be concerned.

1 Part of the material of Chapter I was utilized in an address on "The Problems of Exchange Control," delivered to the Economic Society of Warsaw on May 20, 1935.

2 Used throughout instead of the longer English equivalent "foreign bills of exchange."

3 Bank for International Settlements, Monetary and Economic Section, "Note on Certain Monetary Aspects of the Liquidity Crisis, 1931-32," mimeographed (Basel, April, 1932), pp. 9-10.

The earmark of exchange control in a sense appropriate to Continental systems since the crisis of 1931 is not stabilization, but protection against loss of value in the monetary standard through *capital flight*. Common to all types of exchange control in this narrower sense we find by consequence a more or less categorical prohibition of all outward capital transfers except under official auspices, and a monopoly of devisen trade by the state to implement the prohibition. Even the mildest form of exchange control of this genus, a type which involves neither enforced official rate of exchange nor rationing of devisen, implies rather far-reaching interference.

In order that private persons should not employ devisen to send or bring capital abroad, it is necessary for the state to commandeer all domestic supplies of devisen or scrutinize their utilization in every instance. Not only existing stocks of devisen but also devisen receipts from the export of visible or invisible items have to be sold to the National Bank, they can be retained only for approved uses. Ordinarily this necessitates official insight into accounting records and bank accounts of individuals and firms. Capital flight need not be restricted to devisen, however precious metals and currency may be sent out to establish accounts in foreign banks, goods may be exported and the proceeds left abroad, or the domestic bank account of a foreigner may be transferred within the country to pay an obligation which would otherwise have brought a devisen (short-term capital) transfer.¹ Accordingly, all such practices must be narrowly regulated or prohibited. Furthermore, since clearing and compensation automatically eliminate the possibility of leaving export proceeds abroad without being balanced by import, these devices — frequently imposed of necessity by the existence of exchange control abroad — may actually be welcomed as additional bulwarks against the flight of capital. All these measures are involved in the stoppage of capital flight, whether the embargo is enforced merely upon the country's nationals or upon them and foreigners as well.

The former and milder alternative seems to be the system which England has launched in the present war. "Sterling may be a controlled market, but the phenomena of blocked sterling

¹ On these various possibilities, cf. F. W. Paish, *The Effects of Foreign Exchange Control on British Trade*, U.K. Memorandum No. 2, International Institute of Intellectual Cooperation (Paris, 1939), pp. 2-6.

balances and of transfer moratoria are not as synonymous with exchange control as totalitarian experience would seem to suggest",¹ payments upon pre-war foreign obligations in gold or devisen are to be transferred as required² Quite obviously this milder form of our second type of exchange control is limited to a country with adequate gold and devisen reserves

Even the more severe form, enforcing a capital-export embargo upon nationals and foreigners as well, still preserves relative liberality, since we have not yet arrived at exchange control which attempts to enforce an official and usually artificial parity rate of exchange. Nevertheless, the embargo on capital withdrawals by foreigners will cause the control country's securities and the various categories of blocked accounts to go to a discount abroad. Thus it is seen that discounts on *Sperr* varieties of a currency do not necessarily imply an overvaluation of the ordinary money or devisen.³ Once securities and blocked accounts sell at a discount, however, there arises a further characteristic feature of exchange control—the differential between the foreign and the domestic quotation upon a security or frozen account represents a windfall profit of exchange control involuntarily contributed by the creditor. The debtor, usually only by illegal means, may exploit the margin himself and pay off obligations at bargain rates, more frequently the state appropriates the gains of security repatriations or blocked account liquidations as a source of subsidy for exports. Exports financed in this way are called "additional," though there are other sources of "additional exports" yet to be explained.

From the autumn of 1932 until May 3, 1935, when the conversion of 11,000,000 Schillings of blocked accounts was announced for the near future, Austria presented a fairly clear example of the second subdivision of the second main type of

1 *Economist* (London), September 9, 1939, p. 493. Moratorium could indeed be regarded as a part of exchange control, but since the latter usually permits *some* repayments but, again unlike moratorium, allows *no* capital flight by nationals, I have adhered to the popular usage.

2 Explanatory Leaflet Defence (Finance) Regulations (London, September, 1939). (This is presumably a government publication, but no source appears.) Later dispatches, however, indicate departures from this policy—"The diffidence of the authorities in giving their permission to such conversions... has already created the phenomenon of blocked sterling." *Economist*, September 23, 1939, p. 568.

3 Paul Einzig, *Exchange Control* (London, 1934), p. 128.

control Clearings and the entire apparatus for preventing capital export by citizens and foreigners persisted from a more rigorous regime in 1931 and early 1932, but foreign exchange was dealt in upon a substantially free market and practically no resort was had to allocation of devisen. There was thus realized a system of capital-flight prevention which dispensed with so many of the major interferences involved in other systems that one may well hesitate to apply the term "exchange control" *sans phrase*.¹ Having in mind the further departures from a liberal international system to which we now turn, I have not refused to consider the Austrian case an example of "successful termination" of exchange control in any rigorous sense.

A third degree of intensity in control is reached when, beside prohibiting outward capital remittances and adopting the necessary complementary measures, a country sets official prices upon the foreign exchanges and tolerates no other quotations. The purpose of this measure is to reassure the popular mind, which is prone to identify exchange depreciation (including devaluation) with outright inflation. Now it is of course only too probable that any one of a number of circumstances may shortly cause the "real" rate of exchange for the controlling country to fall below official parity. The difference between the present or third type of exchange control and the fourth type lies in the divergent character of the causes of such a possible disparity. From the side of supply of and demand for bills of exchange *without reference* to relative price-level developments at home and abroad, the real equilibrium price may fall below official parity because (1) the state itself transfers interest or amortization abroad more rapidly than permitted by the current national demand for imports in terms of exports which the economy offers in payment, or because (2) evasion of the state prohibition of private transfers abroad confronts the same inelasticity. From the side of supply and demand for bills of exchange directly *dependent upon* relative commodity prices, real equilibrium may fall below official parity because (3) there has been monetary inflation or lagging deflation relatively to foreign countries, or (4) a flight from the currency into real value has produced price-level developments similar to the preceding ones (under 3), or finally (5) because through cost

¹ Karl Schlesinger, "Kapitalfluchtbehinderung? Ja! Devisenbewirtschaftung? Nein!", Österreichischer Volkswirt, Vol 24, pp 290-294, 325-327

or demand changes the barter terms of trade have shifted adversely If the disparity of real and official rates arises from the forces described under (1) and (2), the exchange control belongs to the third type, if the disparity arises from forces (3) (4) or (5) either alone or in conjunction with (1) and (2), the fourth type of exchange control is present

How can this distinction, apparently of a rather formal character, possibly assume enough practical significance to constitute two separate categories of exchange control? The answer rests simply upon the fact that the two situations require quite different policies in several respects For the former, the mechanically appropriate action would be a stoppage of the excessive outward capital movement, for the second, restriction of credit, reduction of costs, or an increase of production In the former situation, the official rate represents no distortion from purchasing power parity or some other (more reliable) index of equilibrium, and consequently exports and imports at the legal rate are not, respectively, penalized and artificially stimulated Finally, exchange control of the third type does not *necessarily*¹ involve authoritarian allocation of devisen for commercial purposes, since demand and supply for trade purposes naturally tend to equilibrium, whereas a disparity in price-level developments in comparison with foreign countries, unaccompanied by a downward adjustment of exchange rate, brings an excess in the demand for devisen over supply and the necessity for rationing

Prior to April 26, 1936, Poland pursued a policy of deflation and free exchange on an open gold standard The introduction of exchange control and official rates on devisen apparently ushered in a system of the third type prices rose in Poland less rapidly than on world markets, the zloty showed no tendency to depreciate, no protection was afforded domestic producers, and though import devisen were allocated by a semi-official scheme, no complaints were heard as to a shortage of imported raw materials²

In general all countries introducing exchange control immediately after the credit crisis of 1931 found themselves sooner or

1 Devisen rationing would become necessary, if the leakage of devisen by capital flight exceeded the amounts of devisen which the state can commandeer from existing private hoards

2 Jerzy Nowak, *Le contrôle des changes en Pologne*, Comité Central des Institutions Polonaises des Sciences Politiques (Warsaw, 1938), pp 11-13, 17, 21, 22, 25

later in the fourth category, having not only official but, in the light of international price comparisons, also artificially high rates of exchange. This feature extends also to the fifth type, characterized by its metamorphosis from an instrument of monetary policy to a permanent device of commercial and political policy. An exchange control system belongs to the fourth type if the allocation of devisen proceeds upon some mechanical basis without ulterior aims as to the composition or direction of trade. With certain qualifications, the German exchange control system conformed to this description until the end of May, 1934. Devisen were in general allotted to importers in all lines upon the basis of a uniform percentage (which had successively to be reduced) of the average monthly imports in each line during the period July 1, 1930, to June 30, 1931.

Viewed from the angle of freedom in international trade and finance, exchange control reaches its nadir in being perverted to a weapon of commercial policy, particularly of autarkic policies. The first step usually comes in the innocuous form of favouring necessities against luxuries in rationing out devisen for imports. From this departure from purely monetary operations, the way leads by easy stages to discrimination against imports of finished products, to favouring imports needed in *Planwirtschaft* and rearmament programs, to shameless partisanship regarding particular vested interests at home, and finally, in conjunction with the weapon of bilateral clearings, to arbitrary deflections of exports and imports from one country to another as a method of political intimidation or bribery.¹ Exchange control lent itself readily to the designs of commercial and political policy when trade maneuvering by other means was precluded by existing trade agreements.² A maze of intricacies, mingling monetary considerations, producers' selling motives, and political strategy, is presented by systems of multiple exchange rates, culminating in different rates of exchange for every country and for nearly every article of export and import. At a minimum this might signify merely an

1 The maneuvers of Germany in Danubian and Balkan trade in this respect are the subject of Paul Einzig's *Bloodless Invasion* (London, 1939). From the analysis of German exchange control (Ch IV of this monograph), it will appear that Einzig's account is not entirely free from exaggerations.

2 Alexander Yovanovitch, *Mémoire sur le contrôle des changes en Yougoslavie*, Institut International de la Coopération Intellectuelle (Paris, 1939), p. 46.

effort to offset inaccurate official rates of exchange in foreign countries and differential treatment of various commodities through subsidies, quotas, and the like. Frequently, however, differential exchange rates signalize attempts at discriminating monopoly, and the same motive lies behind the exactation of free devisen payment even from exchange-control countries for a certain proportion of exports of a commodity wholly or partly monopolized by the country of origin — as, for example, for oil exports from Rumania. Differential exchange rates may finally — as would be quite patent — afford a convenient, flexible, and at least partly secret method of political discrimination.

WHY WAS EXCHANGE CONTROL INTRODUCED?

Thus far we have devoted our attention to exchange control through unilateral action by one country, with only passing reference to bilateral agreements in the form of clearing, compensation, and payment arrangements, which inevitably accompany the former regulation. This procedure is warranted by the fact that clearings and the like followed both chronologically and logically upon the imposition of exchange control in domestic matters. Before it can be shown how the bilateral controls developed from the unilateral measures, it seems requisite to examine why exchange control in the narrow sense was itself resorted to by so many countries in order to meet the capital flights of 1931.

Gustav Cassel once took the position that a flight of capital is nothing dangerous for a national economy, inasmuch as it represents either (1) a mere exchange of titles, of credits owned at home for values owned abroad, in which event the transaction is merely nominal, or (2) an outflow of real goods through a favorable balance of trade, in which event the transaction represents an export of real capital, but an outflow which, by reason of its limitation to new saving or undermaintenance of existing investments, is too slow a process to cause serious disruptions.¹ The equanimity with which Cassel viewed capital flights must be ascribed to a tendency to regard the position of exchange rates as determined exclusively by relative price levels — capital movements could at most cause temporary, and hence not very serious,

¹ Gustav Cassel, *Money and Foreign Exchange after 1914* (New York, 1922), pp. 443-444.

deflections of market exchange rates from equilibrium, which he believed to be described under "purchasing power parity"

Now the truth is that the exchange of titles, which Cassel took to be "nominal" in two senses of the word, is really the occasion for disaster, and that the exodus of "real" capital, instead of being the real danger in the immediate situation, is actually one solution of the trouble. A flight of capital pertains in the first place to capital in the form of fluid funds, it consists in a panicky effort to get rid of values in terms of domestic money in exchange for values in a foreign currency. The impact of this demand for devalues will drain away the country's gold or devalues reserves as long as they last and thereafter result in exchange depreciation. These are the disaster — events outside the realm of real capital. To the degree that real capital is exported, i.e. to the degree that a favorable balance of trade develops under stimulus of the falling rate of exchange, the disaster to central bank reserves and to the currency standard through further depreciation may be checked,¹ but the response of exports through the "price-specie-flow" mechanism may be tardy and entail collapse of the domestic credit structure and the exchange rate. Letting the capital flight run its course — on the grounds that it is either nominal or, if real, negligible — resembles the therapy of letting pneumonia take its "natural" course.

Capital withdrawals from a national economy present an exact parallel with depositors' runs upon banks, if the phenomenon is sufficiently severe, the same remedy has to be applied, namely, a closing of the wicket. For England the magnitude of capital flight in 1931 relatively to resources, which had been bolstered up by the Banque de France, did not entail a breakdown of national liquidity, but the debtor countries on the Continent had to proclaim bank holidays because of a threatened disappearance of

1 Capital flight may take the form of leaving the proceeds of exports on deposit with foreign banks. In this case the export can at best do *nothing* toward supporting the country's exchange rate, if the export was made *ad hoc* and not in answer to ordinary profit motives. If the export would have been made anyway in line of ordinary business, the practice referred to actually *reduces* the exchange rate. Furthermore, the withdrawal of capital in real form may reduce the production of a nation, though in the widespread underutilization of capacity following 1931, this was probably not serious. Neither of the foregoing qualifications seems to impair the validity of the generalization made above.

reserves It is in such circumstances that the problem arises concerning the future course is it to be moratorium, currency depreciation, deflation, or finally, locking the wicket for the discernible future by exchange control?

Moratorium has sometimes been recommended as the simplest and most honest course, but in fact simplicity and honesty are its chief detractions Its too great simplicity lies in its failure to cover the domestic flight of capital In the summer of 1931, the runs upon the Credit Anstalt, Daimstadter, and other large banks and the domestic demand for gold and devisen revealed the psychology of mistrust within the country to be quite as crucial as foreign withdrawals The too great honesty of moratorium, certainly in 1931 when creditors had not yet been humbled by vicissitudes of subsequent years, would have been the hostility engendered with foreign lenders and then governments Unless moratorium signify outright repudiation, it eventually necessitates negotiation and agreement with creditors Not without considerable plausibility do bankers and members of Treasuries and Ministries of Finance in central European countries argue that negotiation with foreign creditors could not come to any fruitful results until the effort at transfer, in the magnitudes initially demanded, had first broken down under the sheer force of disaster Immediate imposition of moratorium would simply have postponed a test of transfer capacity, meanwhile subjecting creditors to a measure more properly regarded as the last resort

We must consider next the proposal to counteract loss of reserves and decline of exchange by deflation Writing for the International Chamber of Commerce, Professor Mises maintained that "Countries which do not resort to inflation do not put themselves in a position where it might appear advisable to have recourse to those measures comprised under the term 'Foreign Exchange Control'"¹ Ostensibly this opposes inflation and does not actually recommend deflation But when world prices are falling, mere passivity spells relative inflation a country experiencing capital withdrawals must deflate absolutely, and indeed to a greater degree than foreign countries

Deflation is the remedy of economic orthodoxy, since it

1 Ludwig von Mises, "The Return to a Free Foreign Exchange Market," mimeographed report to the Vienna Congress of the International Chamber of Commerce, May 30, 1932 (Paris, 1932), p 2

dispenses with breaching the international money and finance mechanism through departures from gold parity, through defaults upon loans, and through direct authoritarian interference with exchange dealings and commerce. Where a reasonable hope can be entertained for bridging over a flight of capital through a temporary loss in reserves and a subsequent activation of the trade balance by reducing prices, the ends striven for through deflation — integrity of monetary standards, inviolability of contracts, free private initiative in trade and capital movements — are worth substantial sacrifices. Unfortunately from several angles many countries found that, in the midsummer crisis of 1931, deflation promised too little or bid fair to cost too much.

(1) For the weeks of intense panic, credit restriction would have been very limited quantitatively by reason of widespread illiquidity within the several countries. The operation of a high bank rate was, practically speaking, reduced to penalizing new borrowing from the banks on the one hand, and to attracting new supplies of *devisen*, either from short-term loans from abroad or from domestic hoards. But, as Marschak pointed out at the time of the first German exchange control laws in August, 1931, a 15 per cent or 300 per cent rate can be nullified for any of these purposes by a "flight psychology" of sufficient intensity.¹ At best it seems probable that exchange control of some degree was necessarily as a provisional measure, even for a policy of eventual free payments, parity, and deflation.

(2) Once the acute stage of crisis had passed, would it be possible to develop by means of deflation adequate price differentials and sufficient exports to counterbalance the egress of capital? The ordinary forces making for downward inflexibility of prices, such as cartelization in industry, collective labor action, and irreducible "social" budgets, were especially potent in Central Europe in 1931. In foreign countries the inflows of gold and foreign exchange failed to produce any sensible effect upon prices — bank reserves increased without stimulating investment. Deflation would have tended toward balancing out the capital exports more largely by reducing imports than by increasing the export of goods and services. Finally, the price-specie-flow mechanism could not

¹ Jacob Marschak, "Diskontpolitik," *Der deutsche Volkswirt*, vol. 46, p. 1553.

be trusted to work without lagging behind the export of capital far enough to force currency depreciation¹

(3) Let us assume that, despite these very real difficulties, deflation can actually develop an adequately favorable balance to equilibrate with the flight of capital does it necessarily follow that the policy is socially desirable? By the summer of 1931 depression had already prevailed for two years, and there is good reason to suppose that it had already reached a stage of "secondary deflation,"² wherein any imaginable corrective value had disappeared and a mania for liquidity had begun to carry the volume of output and employment with cumulative momentum downward. The counsel of academic economists was probably generally in this direction, although this Diaconian severity must have been weakened by Keynes' two *magna opera* since that time. Economic practitioners in central banks and Treasuries have, at all events, rather generally testified that the cost in unemployment counted heavily against the deflationary method of securing equilibrium.

(4) In point of fact, whether a country suffering a capital flight actually did set in upon a rigorous regime of deflation without exchange control, as in the case of Poland to 1936, or whether it adopted exchange control without being able to support the existing parity, as in the case of Austria during 1931 and 1932, or finally, whether it introduced exchange control and carried through substantial deflation, as in Germany under the Bruning ministry — these divergent courses have to be explained, not in terms of a nice calculation of advantages, but rather in terms of political forces and vested interests. Subsequent chapters upon particular countries will elucidate the factors at work.

A variant of the policy of deflation, as formulated by Machlup, would consist essentially in an iron-clad refusal of the monetary authority to create loans for purposes of a flight into foreign currencies, and a readiness to accept some temporary depreciation.³ The financial wherewithal for purchasing devisen could come from three direct sources, according to Machlup: hoards, income including new savings, and business turnover, and from three indirect sources, namely, sale of property, termination of loans.

1 Herbert Gross, "Ausgangspunkte, Formen, und Wirkungen der Devisenzwangswirtschaft," *Archiv für Sozialwissenschaft*, Vol 69, p 54.

2 Wilhelm Ropke, *Crises and Cycles* (London, 1936), pp 119-134.

3 Fritz Machlup, "Die Theorie der Kapitalflucht," *Weltwirtschaftliches Archiv*, Vol 36, No 2, pp 512-529.

and new bank credit. Each of these, with the exception of the sixth, is rather narrowly limited unless the sixth comes into play. If the central bank refuses to supply new credits, the capital flight would rather quickly burn itself out by reaching the limits of available funds.

No doubt with an absolute limitation on total credit, the amount of purchasing power which can be deflected to a given market, be it for devisen or for a specific commodity, encounters limits of the sort described by Machlup. No doubt, furthermore, the longer the period the greater is the volume of its total liquid resources which a society can direct to a given purpose, even if the total is fixed. A desire to effect an outward capital transfer being given, the society would progressively switch the destination of expenditure from other things to devisen, causing a deflation in the prices of goods and an inflation of devisen prices. Deflation of this character is bound however to be relatively small, since the market for devisen constitutes a small fraction of the total turnover in a national economy. Consequently, while Machlup's policy of fixing the total credit volume would certainly bid fair to support the flight country's rate of exchange better than a policy of inflation, it would not guarantee the necessary deflation, if prices at the same time were declining abroad. The proposal does not consider the problem of the possible shrinkage of income and employment, nor the political aspects of the situation.

Deflation has been examined at some length for the reason that, whether actually attempted or not, the idea was always entertained seriously. The third alternative to exchange control, exchange depreciation — whether through letting the rate sink to its "natural" level or through an act of devaluation — was of course proposed in some quarters outside the sterling bloc, but in the debtor countries was never seriously considered until exchange control had been in effect for many months. That a reduction in the monetary unit would have increased the real burden of foreign debts, aside from possible favorable repercussions on national productivity, weighed heavily against such a solution. Sterling devaluation had indeed reduced the real burden, but this did not show that it should be increased again. Throughout exchange control history the "real burden" argument has deterred devaluations or the recognition of *de facto* depreciations.

The really crucial point, however, was another, the fear of a

"velocity inflation" through a domestic flight from the currency into real values It is maintained with almost universal consensus in the countries having experienced post-war inflations that a depreciation of the currency unit on foreign markets would have meant inflation to the man on the street, and that the "inflation conscious" public knows the appropriate line of action In vain does the monetary theorist insist upon the distinctness of devaluation and inflation If the ordinary citizen fails to understand this piece of "academic subtlety," then it becomes precisely that, the flight creates inflation No government in central Europe could face this risk It must not be forgotten that in 1931 deliberate devaluations were something relatively new, at least within the memory of this generation, sterling devaluation had not yet demonstrated its distinctness from the post-war currency debacles

BILATERAL AGREEMENTS CONCERNING
INTERNATIONAL PAYMENTS THEIR CHARACTER AND THE CAUSES
OF THEIR EMPLOYMENT

Clearings, compensations, and "payment agreements" in the narrow sense represent the three varieties of international payment under bilateral agreement As the League of Nations investigation reveals, they grow directly out of exchange control,¹ indeed, so intimate is the association that it is practically impossible to conceive one without the other This has produced a certain embarrassment in terminology When the specific measures are being considered, "exchange control" designates the unilateral, and "clearing" and the like the bilateral actions But when economic results are the subject of discourse it is frequently impossible to distinguish those flowing from unilateral measures from those arising from bilateral agreements, and the term exchange control is used to refer to the nexus of both sets of regulations I have not attempted to improve upon this somewhat elastic usage, the context usually reveals whether exchange control should or should not be understood to include bilateral agreements

To prevent evasion of the embargo against monetary transfers of interest and amortization abroad, exchange control prohibits all payments not specifically included under its own auspices Two reasons for international bilateral action immediately put

¹ League of Nations, Enquiry into Clearing Agreements (Geneva, 1935), p 10

in their appearance (1) foreign creditors desire to arrange for some repayments even if payments must be conditioned by the size or existence of an export surplus on the debtor country's side, the authorities of the latter are anxious to limit repayments to capacity to pay in goods, (2) importers in the exchange-control country and exporters in the foreign country desire that the blocking of payments by the exchange-control country shall not simply terminate their activities Clearing, compensation, and payment agreements in the narrower sense provide a solution of complementary desires under (2), while clearing and payment agreements provide the outlet for complementary desires under (1). If arrangements can be struck whereby (1) existing debts can be gradually liquidated out of current trade despite exchange control, by the same token such an arrangement permits (2) current trade to go forward Let us see how this can be done

Foreign creditors can force consideration of their claims, whether financial or commercial, if the creditors belong to a country which on current account buys more than it sells to the exchange-control country, provided the creditors can persuade their government to hold up payments on current account and divert a fraction of them to debt liquidation This can be done by forbidding importers, even in the free-exchange country, from remitting directly in devisen to the foreign exporter, and by requiring importers to pay the sums in home currency into a central agency, which, after abstracting a certain amortization quota, holds the remainder as an account to the credit of the foreign exporters The exchange-control country, on its side, will submit to a greater or smaller repayment quota according to its estimate of the importance of this particular export market and of the elasticity of demand for its products

This was in general the setting for the introduction and persistence of clearing and payment agreements between the western European creditor and the central and eastern European debtor countries But at the outset of exchange control the debtor countries refused to pay in devisen except for the case in which they had no choice, i.e. for current imports from a free-exchange country with which they had *unfavorable* balances Accordingly, the western European countries had, as the price for exacting payments on capital account, to agree to the erection of a central agency in the control country, which should receive importers'

payments in home currency and hold them to the account of foreign exporters. In this way the control country could dispense with devisen, enforce its official exchange rate and create a recognized channel of non-flight-payments. The arrangement is called clearing if no devisen are employed in settling one account against the other. A sufficiently one-sided balance (after allowance of repayment quotas) leads either to direct limitations on its exports by the country with a net credit balance in the clearing, to agreement by the other country to increase its export quotas or extend the list of goods or services purchasable through the clearing, or as a last resort, to a complete stoppage of exporting by the clearing creditor until imports have liquidated the balance. The "payment agreements," appearing after the first access of exchange control severity, require all payments to pass through a central agency in each country — on the debtor (exchange-control) side to enforce its official exchange rate and its embargo on transfer by private initiative, and on the creditor (free-exchange) side to insure the application of the agreed-upon proportion of receipts to debt liquidation. But payments in both directions are made in devisen, so that the settlement of accounts is continuous.

Compensation, like clearing, dispenses with devisen entirely, but unlike clearing, trade does not proceed against open book-account involving a *periodic* balancing of *all* items, but rather an *immediate* offset to *each* parcel of export by an import of equal value. In two respects it is less "liberal" than clearing. It narrows the field of choice for exporter and importer both must first discover the difficult "double coincidence" necessary to barter. And it makes no progress toward the liquidation of frozen claims. In other respects compensation proves less confining than clearing, for it frequently allows some trade to proceed when clearing stands at an *impasse* because of an unliquidated balance, and secondly it sometimes permits, in the concealed form of private bargaining, departures from an artificial rate of exchange enforced in the clearings.

In brief outline these are the modes of bilateral arrangements for international payments and the two reasons for their original introduction.¹ It need scarcely be said that an amazing variety of

1 Heuser gives two *types* of clearing agreement paralleling the two *reasons* for introduction, cf Heinrich Heuser, Control of International Trade (London, 1939), pp 68-71. I have reserved the idea of type to differing tech-

combinations of motives and types characterizes the actual scene. Central European countries stood in a debtor relation to the West, but in a creditor relation to the East and Southeast, and the clearings of Germany, for example, reflect both circumstances. Compensation frequently appears as a subdivision of a payment or clearing agreement. Clearings differ in all imaginable ways, concerning organization, items admitted, transit trade, rate of exchange, duration, settlement of balances, and the like, described by Einzig and the League Enquiry. Occasionally clearings even provide for triangular trade, either directly through triangular clearing (though this is rare¹), or through permitting one clearing country B to receive raw material from country A, selling the finished product to C, whereupon country C pays via the clearings to A for the raw materials involved and to B for the fabrication costs — the so-called Brocchi system. But we need not dwell upon further technical possibilities.

Once exchange control has prevailed for some time, additional grounds may appear for instituting clearings with new countries or for extending the scope of existing agreements (3). Since the clearings include the bulk of ordinary trade, a fair presumption exists that transactions outside the clearings may represent attempts to export capital, to secure this simplification, the net of clearings may be extended (4). A more or less deliberate campaign may be instituted to purchase as much as possible over the clearings, forcing the seller to extend involuntary credits in the way of unsettled clearing balances, obliging his government to shoulder the burden, and perhaps eventually inducing the acceptance of inferior goods in payment (5). Finally, like exchange control itself, clearings may become an instrument for economic and political bludgeoning. The threat of *Zwangsclearing* in many cases has been a justifiable method of forcing recognition of creditors' claims, but all too frequently the control of direction and composition of trade, delivered into bureaucratic hands by the clearing method, has been perverted to partisan interests.

Technical arrangements, once clearing has begun. The League Enquiry, by dividing the first reason into desires to liquidate commercial and financial debts, comes out with three reasons for clearings (p. 11). But there are others, cf. points 3, 4, and 5, above.

1 Sudost Economist, Vol. 1, No. 3, p. 81. One example is the recent triangular clearing of Germany, Rumania, and Jugoslavia.

within the country, to purely autarkic ends, or to intimidation of other countries¹

THE EFFECTS OF ECONOMIC FORCES ON EXCHANGE CONTROL

Exchange control systems described in the first pages of this chapter as belonging to the first and second types do not involve an official rate of exchange. The third type was described as including the imposition of an official rate in a situation in which a black market rate might develop because of evasions of the prohibition of capital exports, but no price-level disparity in comparison with foreign countries exists. In these three cases there is no reason why trade cannot proceed without interference from exchange control. In exchange control of the fourth and fifth types, however, which have been most prevalent in Europe since 1931, this has not been the case. The prices of internationally traded goods fell too slowly to offset the decline of prices in gold standard countries, or failed to decline sufficiently to counterbalance sterling and dollar devaluations, or finally rose more rapidly under the forced draft of totalitarian make-work or rearmament programs than did prices abroad. The official rate came sooner or later to represent an overvaluation of the international purchasing power of the monetary standard. From the differential between official and real equilibrium rate of exchange in commodity trade there resulted a penalty upon exports and a windfall gain to imports. Much of the history of exchange control

1. In *The Exchange Clearing System* (London, 1935), Paul Einzig lists fourteen causes for the establishment of clearings. Such an extended list involves much reduplication and not a little error. Numbers 1, 2, 3, and 14 all refer to the willingness of creditors and the requirement of debtors that debt payments shall be made in goods and not in devisen—the first cause in my enumeration. Numbers 4, 6, and 9 fall under the second cause, the desire on both sides that current trade proceed. Einzig's 11, 7, and 13 amount to my 3, 4, and 5. But his items 5, 8, 12, and 10 are spurious. Clearing does not permit a country to escape such direct quantitative limitation of imports as quotas, import licenses, or prohibitions; furthermore the clearing agency usually has authority to accept or reject any proposed transaction. The allegation that clearing reduces "the disturbing effect of cash transfers" actually gives the thesis of the book, apparently recanted in *Bloodless Invasion*, that multiangular clearing promises to be the ideal international system of the future. Another error is the belief that a country wishes to "balance" its trade with particular countries, balancing may be achieved but only for an ulterior motive. Finally clearing cannot afford a means to "replenish the currency reserve," though admittedly clearing may prevent further depletion of reserves.

turns upon the clash of ordinary business motives with these artificial differentials Had the various governments taken no steps to modify their control systems, the tendency toward unfavorable balances would eventually have brought an absolute cessation of international trade

Devices by which exporters are given the "true" value of their products, or at least something more nearly approaching the yield of exports at an equilibrium rate of exchange, are varied and sometimes intricate A simple method, to which resort was had in Germany, Austria, Hungary and Poland, gave to certain authorized exporters certificates which permitted them to retain enough devisen to pay for their imports of raw materials, provided they rendered a periodic accounting The system declined because the certificate privilege was abused by exporters and because the state discovered that it could trench upon windfall and even normal export profits by requiring the sale of devisen (at the official price) even in excess of an amount leaving intact the devisen required to pay for imported raw materials Rumania, Jugoslavia, Hungary, and Austria employed at various times the device of requiring exporters to surrender various *percentages* of their devisen receipts at the National Bank's official price The percentages could be uniform, or could be adjusted to the "needs" of the particular exporter, or be made an instrument of domestic politics, the state utilized the devisen for its own purposes or sold them at their low official price to exporters judged to be especially in "need" of relatively cheap imported raw materials These circumstances led to the designation of the percentage as the "raw material" quota

Many of the schemes for offsetting the export handicap were rather involved Out of the windfall arising from the discounts on blocked accounts or from the repatriation of securities selling at lower prices abroad than at home, the state in some cases paid a premium to secure "additional" exports The term arises from the notion that it is only the foreign creditois' concessions in selling blocked accounts and securities at discounts in order to realize upon them immediately which makes the particular export possible But this linking does not represent any economic connection it is simply an act of authority At the official exchange rates, exporters cannot compete on world markets, and even to export the previous quantities, they must receive

from some source outside their devisen sales the differential between official and equilibrium rates Whence it comes, whether from surcharges on imports, taxation, or foreign creditors' forced concessions, is a matter of indifference to the exporter And unless the payment he receives exceeded the rate differential, exports are not "additional" to what they would be were it not for the artificially low rates on foreign devisen set by exchange control, and it need scarcely be added that this rarely happens This explains the amusing paradox that during a six-months period at the end of 1933 and early 1934 German exports declined by well over 100,000,000 Reichsmarks, although "additional" exports through the repatriation of bonds and the sale of blocked accounts amounted to 100,000,000 Reichsmarks¹ The real intricacies of the additional-export device appear when a certain portion of one export parcel is declared by an exchange control authority, as for example the Hungarian to be additional, but the other portion not, for the former portion an unusually high premium is paid, but for the latter only the ordinary rate *Ad hoc* administration of this sort easily admits personal favoritism or political pressure, especially as the public does not know the premium paid in particular cases

Equally difficult to administer in objective fashion is the method of offsetting the export handicap by quietly tolerating on occasion exporters' resort to the black market and its better prices for foreign devisen In some countries, most notably Germany in the past few years, the chief method of relief to exporters has been direct state subsidy, a procedure scarcely adapted to secure objectively equal treatment either for exporters themselves or for their products on a comparative cost basis In passing it should be emphasized that, unless the amount paid the exporter exceeds the handicap imposed by official exchange rates, there is neither genuine subsidizing nor, by the same token, "exchange dumping"

Finally, the control authority may levy upon imports a surcharge above the official rates for foreign devisen and apply the proceeds as a premium on exports If these differentials were sufficiently large and applied uniformly, the system could, except for capital transfers, practically reconstitute the conditions of a free devisen market under exchange control, particularly since

¹ Hamburger Fremdenblatt, March 6, 1934.

the differentials are also commonly introduced into clearing rates Hungary has approximated this situation since 1935, without completely realizing it because of some lack of uniformity in the agios and inadequacies in their extent

Commonly, however, as in Jugoslavia and Rumania,¹ different premia are paid for various countries and commodities As previously remarked, this may be "justified" by differing degrees of overvaluation in various foreign currencies or by discriminating treatment of different commodities abroad But this "justification" does not prove the advisability of the system, which may become unmanageably complex and subject to personal discriminations within the control country Differential premia have also been defended as a means of fully exploiting foreign markets For a country actually possessing a monopoly and having furthermore the requisite conditions for discrimination, the theoretical possibilities have been clearly set forth² In the disrupted economic world since the World War and particularly since the crisis of 1931, protective tariffs, quotas, import and export prohibitions, boycotts, government monopolies in traded goods, discriminating railroad rates, subsidies, and exchange control make it certain that national markets are insulated to a high degree for many commodities By the same token, however, these autarkic devices make it more difficult to exploit the differing demand elasticities of the several markets It is, of course, not *a priori* demonstrable that finely differentiated exchange rates could not secure profitable monopolistic discrimination The Hungarian authorities, however, who once categorically affirmed this possibility, abandoned the system for a relatively simple structure of rates Monopolistic discrimination of a very simple variety made its advent early in exchange-control history in the requirement, even from exchange-control countries, of devisen payment for exports produced under conditions of spatial or geographic monopoly Thus Rumania secures devisen for some of its petroleum and Hungary for some of its wheat, even from exchange-control countries

Exchange control passes from type 4 or 5 to type 2 (with or

1 Cf Yovanovitch, op cit, pp 27, 35-36 Cf Virgile Madgearu, *Le contrôle des changes en Roumanie*, International Institute of Intellectual Cooperation, Paris (to be published), pp 17, 37, 44

2 Joan Robinson, *The Economics of Imperfect Competition* (London, 1933), Chapter 15

without autarkic accompaniments) when the authority, instead of attempting to reconstitute something like an equilibrium rate through any of the foregoing devices, tolerates an open market for devisen dealings under its constant supervision. The circle seems now to be joined, and the question may legitimately be put as to why exchange control should persist. There are of course vested interests the control bureaucracy doubtless prefers not to contemplate a change (at best) of employment, and the state enjoys a continuance of its prerogative of purchasing devisen for its own purposes at the low official rate, which still persists as a formality made real for this one purpose.¹ But, as the case of Austria reveals, there are legitimate reasons for the persistence of type 2 to prevent capital withdrawals on a disastrous scale, all devisen dealings have to be scrutinized, and furthermore, the existence of exchange control in important trade partners requires the continuance of bilateral payment agreements.

In the present summary view it is impossible to exhaust the repercussions of economic forces upon exchange control. The account would be quite incomplete, however, without emphasis upon *evasions* of the control and the endless flow of regulations designed to render the system inviolable. One harried official of a central bank confessed privately that evasions were always outstripping enforcement, he predicted the eventual collapse of the system from this weakness. The strength of modern states does not permit such a prophecy with any confidence, but the circumstance emphasizes one important aspect of exchange control — its heavy social cost and complexity.

ECONOMIC PROGNOSIS FOR EXCHANGE CONTROL

Part of the "nature" of exchange control is its economic operation. Without anticipating results of the accompanying empirical studies of particular national economies under exchange control, it is possible to set down in brief form some of the chief economic effects which would appear highly probable or even inevitable from the very character of the unilateral and bilateral measures described in the present chapter.

Authoritarian action of the first type enumerated has already

1 This is said to be one of the chief bulwarks of exchange control in Rumania. Madgearu, op. cit., pp. 9, 21.

been treated in a special literature,¹ it does not belong to exchange control in the narrower sense of the present enquiry. It is the chief characteristic of the second type, permitting the rate of exchange to move freely and dispensing with devisen allocation, that it prevents an exodus of capital. Undoubtedly such an embargo may interfere with the tendency of capital to bring its marginal employments to equality and thus maximize yields. Flight capital, however, can scarcely be thought of in this light. "If the authorities endeavor to prevent abnormal capital movements from affecting the exchanges," says Einzig, "they assist in the working of normal tendencies, instead of obstructing them."² On the other hand, in preventing capital repayments, exchange control effectively discourages the investment of new foreign capital. Since the "natural" direction of capital-flow was toward the debtor (now exchange-control) countries, this is probably the more serious consequence.³ The third type of control presents no important economic peculiarities over this situation, and we pass to the fourth and fifth types, in which overvaluation entails devisen allocation (*Devisenbewirtschaftung*).

It is, for example, possible to foresee with reasonable certainty that the maintenance of a country's exchange at a level higher than that justified by relative prices will penalize exports and give windfall profits on imports. From this simple fact several deductions can be reached. Countries having an export surplus consisting chiefly of agricultural products will discover that their agriculture languishes, if it is already depressed from a combination of secular and cyclical causes, the "agricultural price shears" will be opened still further. Industry will by contraries gain, first in the relative cheapness of imported raw materials at the low official rate on foreign devisen, secondly in the automatic protection afforded through the scarcity of raw materials at the too-low rate, and hence the high domestic prices chargeable for products, and, finally, from the cheapness of domestic agricultural materials. *Mutatis mutandis* the case may be stated for countries with industrial exports.

1 Consult, for example, N F Hall, *The Exchange Equalization Account* (London, 1935), Seymour Harris, *Exchange Depreciation* (Cambridge, Mass., 1936), Chapter 15, and F W Paish, "The British Exchange Equalization Fund," *Economica* February, 1935, February, 1936, and August, 1937.

2 Einzig, *Exchange Control*, p 108.

3 Cf Yovanovitch, *op cit*, p 23.

From a knowledge of the devices by which the artificially scarce foreign devisen — much prized because of their low official prices — are allocated, it would not be impossible to hazard that those economic interests which are most vocal, most highly organized, or most powerful would be apt to secure the most consideration. In general industry and commerce would bid fair to come off better than agriculture, large business units would prevail over smaller units, trusts and cartels would be agglandized, with predictable results upon domestic costs of living.

The detailed scrutiny of individual transactions involving foreign exchange would necessarily involve costs for a hierarchy of employees and officials, furthermore, the exchange control apparatus is almost wholly administrative, and the enabling legislation usually specifically places the controlling authority above recourse to judicial review. *A priori* it would be impossible to know how extensive the costs of the control administration might be, or how economical the management, nor could one foretell whether the administration, endowed with powers of economic life and death, would or would not act impartially and honestly.

Foreign trade under exchange control may be made the object of quantitative prognosis in several respects. Involved are problems as to the direction, commodity composition, volume, and terms of trade, from the angles of both exchange-control and free-payment countries. Here we move in a sphere in which unilateral and bilateral measures articulate closely, though in some cases one or other set comes more prominently to the fore.

A country finding itself in a position of currency overvaluation, if it can or will not accept the alternative of exchange depreciation, must husband its devisen by direct interference with trade. In these circumstances imports from clearing countries will be fostered, those from free-exchange countries reduced as far as possible, and the opposite policy will be adopted for exports. Such a country will naturally exert itself to introduce clearings and compensations with any free-exchange country with which it has an unfavorable balance, and to postpone the advent of such arrangements when its balance is favorable. With those countries with which it already has bilateral agreements it may, either from force of circumstances or deliberately, import as much and export as little as possible. If the possibility exists of deriving an import originating in a country where devisen payment would be necessary,

by way of clearing or compensation from an entrepôt country, the opportunity will be avidly seized upon

What has been said concerning the general changes to be expected in total exports and total imports by countries will also prevail for particular items of trade, i.e. nothing will be taken for payment in devisen if the commodity or service can be had through clearing or compensation. In relations with clearing countries with which it has naturally favorable balances, the exchange-control country will attempt to secure devisen payments for as much of the balance as possible, this it may be able to compass by reason of its relative importance as an export market for the particular country, by reason of threats of various economic reprisals, or by reason of its monopoly control over important export items. Bilateral agreements and exchange control lend themselves readily to autarchic policies. It may be confidently expected that permission to export or import by clearing, compensation, and through a payments office will be given only if the particular item does not displace home production and does not conflict with rearmament programs or other state policies.

What effects may we expect upon the terms, total gain and volume of international trade from the ubiquitous features of contemporary exchange control, its enforcement of some predetermined ratio of exports (or imports) in the bilateral trade of pairs of countries, and its preservation of artificial exchange rates? Conceptual clarity is best served by distinguishing the effects produced by an "ideal" system of universal bilateralism and the effects produced by bilateral clearings as they actually exist. We must also take account of the fact that the dislocation of international demand may exceptionally for a particular country reverse the typical or modal expectation. These three factors, with the addition of artificial exchange rates, give us the four major variables out of which a particular country's situation under exchange control is compounded.

An "ideal" system of bilateralism embracing all countries could be achieved by lowering the rate of foreign exchange in the favorable-balance country and raising it in the unfavorable balance country in each bilateral relationship until the bilateral exports of the two countries stood at whatever ratio had been contemplated in the clearing. The situation is "ideal" (within the limits imposed by bilateralism) in two respects: it is bound to achieve the bi-

lateral balance desired if pressed far enough,¹ and it achieves this end with a minimum of authoritarian interference, since foreign traders can buy and sell where, what, and as much as they desire

At the rate of exchange appropriate to any authoritarian ratio of bilateral exports less than the original situation, the former favorable-balance country experiences a favorable change in terms of trade, and the former unfavorable-balance country experiences an unfavorable change. But it is not true that what one country loses the other gains, for the imposition of authoritarian trade ratios narrows the range of choice for both countries in buying and selling alike. Average export prices would be expected to be lower, average import prices higher. Upon the usual assumption of more than unitary demand elasticity for a given country's products, the former favorable-balance country gains less on the expansion of its imports than it loses on the contraction of its exports, and for the former unfavorable-balance country, the gain on expanded exports does not offset the loss on reduced imports. Foreign trade in comparison with domestic trade is less attractive than before the introduction of bilateralism, and its volume stands to decline.

Actual bilateral arrangements reduce the relative attractiveness of foreign trade still further. In the first place numbers of countries remain outside the system. This narrows the range of free choice for the bilateral countries even more than it had been through the disappearance of free balances under universal bilateralism. *Ceteris paribus* import prices would be still higher and export prices still lower, but this result may be offset in particular cases by the emergence of monopoly and monopsony. The greater probability of the former makes it appear *a priori* probable that certain exchange-control countries, while paying higher import prices, may recoup part or even all of the loss through monopoly advantages which tend to support export yields. Actual bilateralism may be expected to fall short of the net economic product of international trade under the "ideal" system because of *direct interferences* with exports and imports intended to bring about the same trade ratio as would be achieved by exchange rate manipulation. Lack of knowledge of demand and cost functions for particular goods makes it appear *a priori* improbable that these direct

1 Upon the usual and probably warrantable assumption that the demand for a country's exports as a whole has more than unitary elasticity

and *ad hoc* interferences will produce the desired result Finally actual bilateralism serves autarkic ends, by definition these ends are incompatible with maximizing the economic gain of foreign trade

In either the ideal system or actual bilateralism, the redirection of international demand may give windfall gains to a particular country offsetting some or all of the effects delineated as typical By the same token, windfall losses may intensify adverse effects

Overvaluation, the fourth major force in the general constellation, must be understood relatively to the aims of bilateralism A rate of exchange upon a trading partner (as in clearing and payment agreements) which does not achieve the ratio of bilateral trade contemplated in the arrangement causes the accumulation of debt by the overvaluing country Here again it is not true that what one country loses the other gains, for trade on both sides suffers interruptions to permit the liquidation of the debt How the loss through risk, interest charges, and technical outlays on the clearing apparatus is *shared*, between the partner countries depends upon elasticities of demand and supply, but the loss remains

In a final chapter we return to the *a priori* expectations of the preceding pages to determine whether they are validated in actual experience, and whether a theory of exchange control can be further elaborated It is intended that the following studies of individual countries should be intelligible as separate monographs But the ultimate aim throughout the enquiry is a general appraisal of exchange control on the basis of its observed operation

CHAPTER II

AUSTRIAN EXCHANGE CONTROL AN EXAMPLE OF SUCCESSFUL TERMINATION

THE AFTERMATH OF THE CREDIT ANSTALT FAILURE

While the repercussions of the Credit Anstalt failure rocked the financial foundations of Europe, the immediate impact fell most violently upon the small republic of Austria. Beginning on May 8, 1931, when the bank's actual losses of 140,000,000 Schillings transpired and additional losses absorbing the entire 177,-500,000 Schillings of original capital appeared probable, a frenzy of panic loosed itself. Unchecked by the tardy relief from abroad, it led to an absolute *impasse* for the National Bank and the introduction of exchange control five months later. During the first two days of intense panic, the Credit Anstalt lost 15 per cent of its deposits and by the end of the month 20 per cent, or 400,000,-000 Schillings.

To enable this institution to meet demands, the central bank increased its private discounts, as may be seen from Fig. 1, in a tremendous bound from 69,500,000 to 451,300,000 Schillings during the three weeks from May 7 to May 31, almost exactly paralleling the Credit Anstalt withdrawals. The note circulation increased in the same period from 905,400,000 to 1,140,600,000 Schillings, an application of the Bagehot principle for meeting runs. Conclusive proof that the increase of notes merely supplanted deposits, and therefore cannot be stigmatized as inflationary, appears in Fig. 2. The increase of notes proceeded entirely from the thousand-Schilling category, a denomination not much used for exchange but predominantly for hoarding. Foreign withdrawals and domestic hoarding also began their disastrous inroads upon the National Bank's gold and foreign reserves (cf. Fig. 1). A decline from 855,500,000 to 732,200,000 Schillings during May alone provoked only the moderate discount-rate advances from 5 to 6 per cent on June 8, and 7½ per cent on June 16, not until July 23 was the rate raised to 10 per cent, at which level it remained until the introduction of exchange control.

To cope with the basic difficulties of the Credit Anstalt

situation, the government promulgated a series of eight laws over the period from May 14 to December 23. In the first law it provided that the Treasury should assume 41,400,000 Schillings and the National Bank 12,400,000 Schillings of the 140,000,000 Schillings losses, the balance being covered by offsets from reserves, writing down the existing capital, and a contribution from the Rothschilds. The government also subscribed 58,600,-000 Schillings and the National Bank 17,600,000 Schillings to new capital.

Well aware that foreign withdrawals might only have begun, the Austrian government addressed appeals for loans to London, Basle, and Geneva. The Control Committee of the Bank for International Settlements authorized an emergency credit on May 18, but nothing was done to make the funds available. On May 25, according to the Austrian Prime Minister, Ender, the Bank of England advised the Ministry of Finance either to declare bank holidays for the Credit Anstalt or to announce a moratorium; alternatively, it promised a loan in conjunction with the Bank for International Settlements, if the Austrian government would underwrite the obligations of the threatened bank. The underwriting law was enacted three days later, and the government also guaranteed National Bank rediscounts of 120,000,000 Schillings to the Credit Anstalt and Austrian Savings Bank advances of 50,000,000 Schillings.

Even so, no foreign credits appeared, although the first weeks of June saw a continuation of withdrawals from Vienna banks at the rate of 100,000 Schillings daily. From Paris a tardy offer of help was made upon conditions politically impossible for Austria: definite renunciation of a tariff union or *Anschluss* with Germany, and supervision of the reorganized bank by the Quai d'Oissay. Finally, on June 16, the French conditions for a possible loan took the form of an ultimatum which caused the collapse of the Ender cabinet. Rumors of moratoria and exchange control were rampant. At midnight came the news of a 150,000,000 Schillings credit from the Bank of England. This precipitated action by others: the Bank for International Settlements immediately lent 100,000,000 Schillings and announced its willingness to supply an equal sum in addition¹, in return for an explicit guarantee of Credit Anstalt.

¹ Actually this sum was not subsequently supplied, and instead the original advance was reduced to 90,000,000 Schillings. Furthermore, the Bank

deposits, a consortium of more than a hundred of its foreign creditors agreed to a two-years postponement of claims. The "London Agreement" of June 16 covered 500,000,000 Schillings, the bulk of the Credit Anstalt's short term obligations¹.

The announcement of the Hoover moratorium on June 23, 1931, induced a temporary optimism, but a sharp reversal ensued on July 13 when the failure of the Darmstadter and Nationalbank, involving its Vienna concern, the Mercurbank, led to the German bank-holidays. Austria suffered, therefore, not only directly from the Credit Anstalt bankruptcy, but also from a return of the virus from its devastation abroad. In Germany and Hungary foreign payments were suspended, and Austrian citizens, apprehending similar measures at home, renewed the conversion of deposits into notes and devisen. On July 25 the third, fourth, and fifth Credit Anstalt laws carried on the work of reconstructing this bank, but the panic continued with an estimated reduction of short-term foreign obligations of Vienna banks, excluding the Credit Anstalt and direct loans to industry, from 400,000,000 Schillings before the May crisis to 250,000,000 Schillings at the beginning of August. Devisen reserves in the National Bank shrank in the same period from 855,000,000 to 566,000,000 Schillings, despite the 250,000,-000 Schillings credits from the Bank for International Settlements and the Bank of England.

In this extremity the government addressed a desperate appeal on August 7 to the League of Nations for a 250,000,000 Schillings loan. Representatives of the Financial Section went to Vienna to study the situation, but not until the summer of 1933 was the loan actually consummated. However, a meeting of foreign bankers in Basle, August 14-19, accorded a six months' standstill upon the remaining 240,000,000 Schillings² of Austrian banks' short-term debts, under the so-called Bruins agreement³. of England required a repayment of 50,000,000 Schillings of its advance, and thus hastened the advent of exchange control.

1 By subsequent agreements on January 11 and April 27, 1933, its affairs were finally put in order through a "Foreign Holding Company" with the participation of the Austrian Government. On July 20, 1934, the guarantee of its deposits was finally terminated.

2 All figures in Schillings to p 54, paragraph 1 are given on the basis of gold parity, thereafter at the "private clearing" rate.

3 The standstill was renewed on January 20, 1932, and at six months intervals thereafter until repayments and other arrangements supplanted it entirely on December 10, 1934.

Simultaneously in mid-August the Hungarian government promised to permit 50 per cent repayments upon all Austrian claims falling due before September 12, but its failure to transfer more than 3,000,000 Schillings from a total of 10,000,000 Schillings contributed to the embarrassing shortage of devisen. During August a further 5,000,000 Schillings was withdrawn from Vienna banks.

The rapid ebbing away of devisen reserves had created a shortage of foreign exchange immediately after the Credit Anstalt collapse, so that transactions of any importance proceeded on a premium basis for gold currencies. In September the phenomenon became commonplace, though the large banks found it more seemly to sell only at National-Bank rate, the informal (but still legal) coffee-house dealings involved premia of 10-15 per cent. After the Stock Exchange was closed on September 21 to stay the process of liquidation and capital flight,¹ the Bank officially limited its sales of devisen to "legitimate" import demands, but even so the supply proved inadequate. On October 7 the Ministry of Finance suspended remittances abroad by money order, and on the 9th the First Devisen Law was proclaimed. Reserves of the National Bank had fallen by that time from 855,500,000 Schillings on May 7 to 358,900,000 Schillings; private discounts had risen from 69,500,000 to 736,200,000 Schillings.

For several years preceding 1930, Austrian indices of production and of note circulation had followed roughly parallel courses. The continuation of note circulation secularly upward during the latter half of 1930 and the first months of 1931 did not signify relative inflation, despite a persistent decline in the production index (cf. Fig. 7, p. 61), since diminished velocity through hoarding offset the purely quantitative increases. Savings deposits, from an average of 2,119,000,000 Schillings in 1929 increased to 2,392,000,000 Schillings by June, to 2,512,000,000 Schillings by December and to 2,620,000,000 Schillings by March, 1931. For May there decline to 2,320,000,000 Schillings does not mean diminished hoarding but rather a flight from the banks attending the Credit Anstalt debacle; this interpretation holds also for the still lower savings deposits figures of the second third of the year, which is marked in the note circulation curve by a hump corresponding to the hoarded 1,000 Schilling notes (cf. Figs. 1 and 2).

1. The Exchange reopened in early November, 1931.

By September, however, the foreign short-term obligations of all Vienna banks, including the Credit Anstalt, had been prolonged by agreements, and government guarantees had assured bank

THE AUSTRIAN NATIONAL BANK*

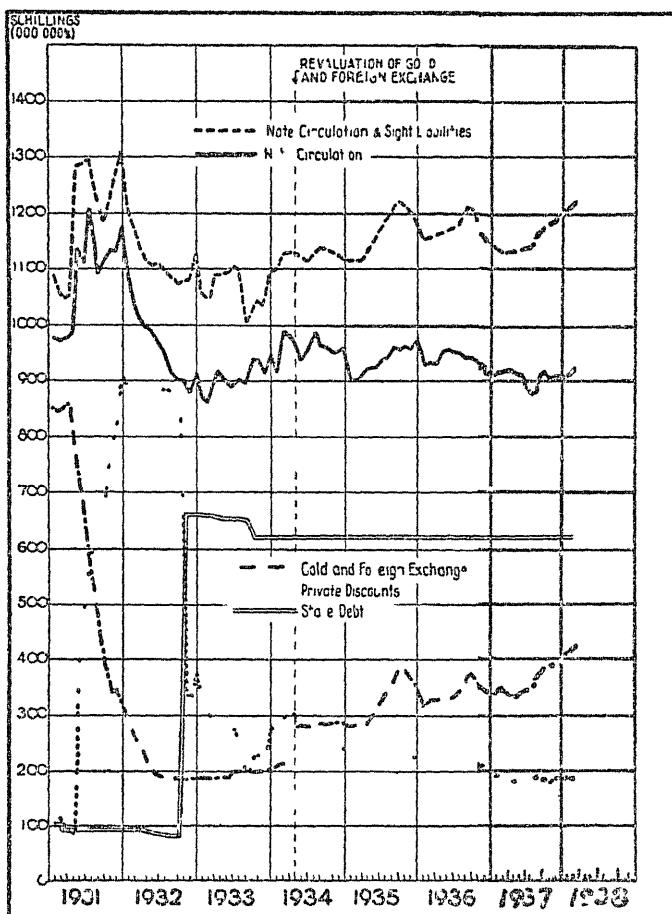


FIG 1

* League of Nations, Austria Public Finances, First Report (Geneva, 1936), p. 12, extended to termination of the Bank's existence in March, 1938. The decrease in private discounts and simultaneous increase in state debt are explained by the absorption of Credit Anstalt losses by the Treasury. Cf p. 54, n. 1, below. For statistics, cf pp. 349-351, below.

liquidity. But the sapping away of central bank reserves through capital flight, continued by Austrians and foreigners alike, caused popular apprehension to turn now from the banks to the currency. Reductions in savings deposits persisting throughout the final third of 1931 to a low point of 1,878,000,000 Schillings in Decem-

BANK NOTES IN CIRCULATION BY DENOMINATIONS*

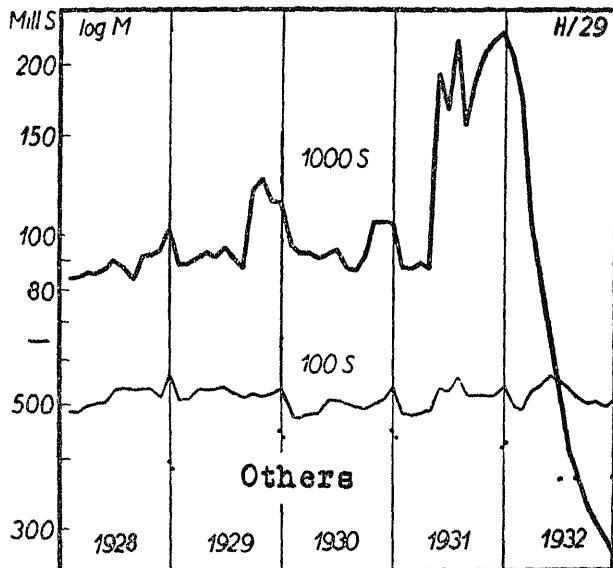


FIG 2

* Monatsberichte des Österreichischen Instituts für Konjunkturforschung (hereafter O I f K), Jhrg 7, Nr 2, p 19. For statistics, cf. p 350, below.

ber signify a flight from the currency and an acceleration of monetary velocity. During the same interval, doubtless partly as a consequence of the reduction of bank-rate from 10 to 8 per cent on November 13, the note and deposits index rose from its temporary low of 123 in October to a maximum of 131 in December, 1931 and February, 1932.

The inevitable result of increased velocity and quantity of central-bank notes and deposits was a pronounced upward sweep in the Austrian sensitive-price index, beginning in September, 1931. Fig. 3 shows its departure from the downward course of world gold

prices as typified by the United States¹ We shall return later to the data in Figs 1 and 3 for an explanation of the eventual devaluation of the Schilling by 22 per cent, at present we note that price equilibrium with gold countries such as America persisted until September, 1931, but that thereafter the official parity quotations on the Schilling were maintained in the teeth of a decidedly adverse turn in purchasing power parity

At this juncture questions naturally arise as to whether Austria had anything to gain by introducing exchange control in October, 1931, and if so, whether the control should not have been applied much earlier I do not believe it can be seriously doubted that a government's decision to support the banking system is necessary to prevent wholesale financial demoralization,² and that for Austria this decision inevitably involved sacrificing the monetary standard, unless foreign loans had been forthcoming quite beyond the bounds of probability in 1931 With these considerations as data, the authorities might simply have let the Schilling "find its level" or have devalued by an incisive step shortly after the Credit Anstalt crisis Against this course, however, stood three important obstacles the popular tendency to identify devaluation with inflation, the burden of foreign debts, and the impossibility of foreseeing a continuance of world deflation Concerning the first, it is imperative to recall (1) that England had not yet given her demonstration of the practical feasibility of cutting loose from gold without inflation, and (2) that the Austrian people consequently associated devaluation with the post-war inflations Less conclusive, but still important, was the per-capita foreign indebtedness of 476 Schillings, substantially less than Hungary's 766 Schillings but approximately equal to that of Germany or Rumania Devaluation would have aggravated not only the real burden of debts in foreign currencies, but also the difficulty of coming to an understanding with foreign creditors Finally, the conversion of Credit Anstalt deposits into central bank and government obligations did not *per se* mean inflation, but only the crystallizing of the credit volume against downward revision Who in October, 1931,

1 Experience with these two series has indicated to the Austrian Cycle Research Institute that closest conformity through a number of previous years is obtained when the Austrian series is advanced by four months A normal divergence of 25-30 per cent of the Austrian curve above the American is eliminated by reducing both to 100 in June, 1931

2 Thus Wilhelm Ropke also *Crises and Cycles* (London, 1936) p 8, n 6

could have foreseen a fall in the international price-level in the immediate future, to say nothing of a continued decline for two or three years to come?

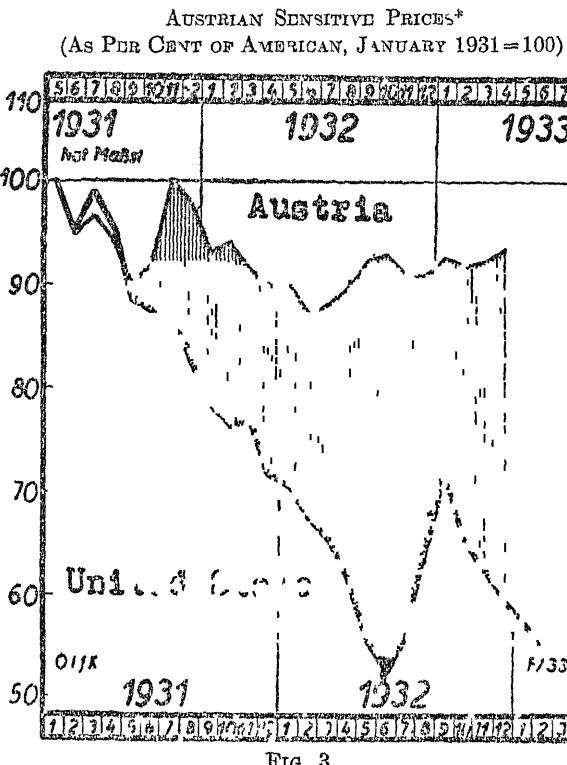


FIG. 3

* O I f K , Jhrg 7, N^o 4, p 65. The time basis for Austria appears at the top, for America at the bottom, of the diagram. For statistics, cf pp 353-355, below.

Another course would have been an attempt to maintain the gold Schilling by deflation. To cope with the panic psychology of a capital flight, sharp and rapid contraction of credit is requisite, with a successful outcome by no means assured. It is difficult to believe that credit could have been substantially reduced. Dr Viktor Bloch called the attention of the *Währungsenquête* in April, 1932, to the fact that of 850,000,000 Schillings in National Bank loans nearly 700,000,000 Schillings directly or indirectly represented frozen Credit Anstalt assets, leaving a maximum of 150,000,000

Schillings which could be affected by the rediscount rate. Though commercial banks would have had to follow this rate, a large portion of their loan portfolios, in turn, were illiquid. Precisely this general condition is recognized by those who say that the cost of salvaging the Credit Anstalt was the gold Schilling, although the same persons inconsistently upbraid the National Bank for not deflating.

Perhaps even more momentous were the purely political considerations. The Social Democratic Party emerged from the elections in November, 1930, with unbroken strength, but the cohesion of the Government's majority was seriously affected, especially later through the ill-starred attempt to establish a Customs Union with Germany. The collapse of the Credit Anstalt virtually put the Government at the mercy of the socialists, and the Buresch cabinet had to coordinate its policy with the wishes of the Left.

The Social Democratic Party took a firm stand against any devaluation of the Schilling. For the masses of the Austrian electorate and even for many leaders of the party¹ devaluation and inflation were identical notions, and the party, accountable to its voters, never could, at least openly, pursue such a policy. On the other hand, the implications of a persistently deflationary policy were even less acceptable, together with the trade unions the party firmly rejected any policy which would increase the pressure on wages and salaries or which would decrease the part of costs of production caused by social legislation.² As early as June, 1931, in confidential meetings of the party, its leaders cited the warning example of Germany where, as they said, the deflation policy of the Bruning Government supported by the German Social Democrats would "cost the latter thirty seats at the next election."³

In their attitude towards the Credit Anstalt problem the socialists were guided first and foremost by the desire to maintain at any price⁴ employment in the industrial concerns owned by the Bank. In place of lowering costs of production, they urged the

1 Cf. Speech of Otto Bauer in Protokoll des sozialdemokratischen Parteitages Abgehalten vom 13 bis 15 November, 1931 (Vienna, 1931), p. 22.

2 The aggregate "social burden" was estimated at 25 per cent of wages and salaries. Die Industrie, vol. 33, No. 8, p. 7.

3 Pertinax, Oesterreich 1934, (Zurich, 1934), p. 163.

4 Walter Federn, "Der Zusammenbruch der oesterreichischen Credit-Anstalt," Archiv für Sozialwissenschaft und Sozialpolitik, vol. 67, p. 427.

Government to restore the viability of this large part of Austrian industry by cancelling the heavy loans these undertakings had obtained from the Credit Anstalt,¹ and they continually demanded a reduction of the National Bank's rate of discount. It was in the main because of the socialist opposition that the National Bank did not raise its rate immediately after the failure of the Credit Anstalt. In the general panic precipitated by sterling devaluation, the socialists did, indeed, vote for a law which reduced the salaries of civil servants and railroad employees and imposed additional taxes on wages and salaries.² But even this shy attempt to pursue a policy similar to that adopted by the German Social Democrats aroused deep distrust amongst the party's membership and represented the last concession politically possible. Under these circumstances introduction of exchange control was the only alternative left, and the socialists readily gave their votes for the Constitutional Act of October 8, 1931, which created the legal basis for subsequent exchange control by cabinet decree. How the introduction of exchange control at an earlier point — for example, on May 8 when the Credit Anstalt failed, or on the occasion of the Danat Bank closing and the adoption of control by Germany on July 13 — would have altered the course of events belongs to the realm of pure guesswork. Since the primary purpose of introducing exchange control is to meet an emergency, the measure should have been adopted at one of these junctures, if ever. The great benefit would have been to preserve devisen reserves against a capital flight. This might have permitted an orderly devaluation in September along with the pound, and probably an immediate return to free payments. On the other hand, the device would have irritated Austria's creditors and possibly have delayed the agreements beyond even their tardy consummation as things were.

The actual occasion for introducing exchange control was England's departure from the gold standard and the further encircling of Austria by control countries. To Germany and Hungary were added Czechoslovakia on October 2, and Jugoslavia on October 7, accounting together for 42 per cent of Austria's exports and 52 per cent of her imports. Those countries which absorbed half her exports without paying in devisen were the very ones from

1 Cf. the "Economic Program of the Social Democratic Party" *Jahrbuch der österreichischen Arbeiterbewegung* 1931 (Vienna, 1932), p. 21.

2 Budget Sanierungs Gesetz, October 3, 1931, BGBl 294.

which Austria had to derive her raw materials Furthermore, although the Credit Anstalt arrangement in June and the Bruins agreement in August prevented the withdrawal of 750,000,000 Schillings of short-term capital, there remained not only an annual debt service on all categories exceeding 450,000,000 Schillings, but also the possibility of an indefinite flight of domestic capital

The League representative in Austria, Mr Rost van Tonningen, appraising the adoption of exchange control, concluded that "No other step could be taken if the foreign exchange necessary for raw materials and foodstuffs and for meeting the foreign liabilities of Austria was to be secured"¹ Dr Viktor Kienbock, the governor of the National Bank subsequently responsible for the virtual abolition of exchange control, regarded its introduction as a means of coping with the loss of confidence attending the underwriting of the Credit Anstalt² Probably the final resort to exchange control was unavoidable Even so, the benefits derivable from control do not seem to have warranted adherence to the old gold parity Had Austria followed the sterling bloc, and had its exchange control been really effective, the same ends would have been achieved as actually were realized after much fumbling and disturbance to trade Certainly it was hopeless to attempt to preserve the old parity of the Schilling with the central bank nearly denuded of reserves and saddled with a mass of frozen assets, with gold prices everywhere declining, and with a National Bank management which permitted even an absolute increase of its credit after the official proclamation of exchange control

THE ATTEMPT AT FULL MONOPOLY, OCTOBER, 1931 TO FEBRUARY, 1932

To anyone uninitiated into the hazards of exchange control, the First Devisen Act of October 9 would appear to insure an entirely adequate apparatus for the regulation of foreign payments The National Bank was empowered to monopolize devisen dealings, to set the rate of exchange (publication of other quotations being forbidden), and to ration out devisen according to its own judgment without legal recourse on the part of private persons Its consent

¹ League of Nations Quarterly Reports on the Financial Position of Austria (cited here under the author's name), Rost van Tonningen First Quarterly Report (January 12, 1932), p 10

² Mitteilungen des Verbandes österreichischer Banken und Bankiers, Bd XVI, Nr 12, p 328

was necessary not only to transfer abroad foreign and domestic means of payment of all categories, including deposit books and deposit receipts, but also for a bank or even for a private firm to credit a foreigner's account on its own books. Foreign means of payment and bank accounts had to be registered and offered for sale to the National Bank within eight days, if their total exceeded 1,000 Schillings, or if their total subsequently reached 500 Schillings. Anyone exporting goods to a value exceeding 200 Schillings was obliged to inform the Bank of the payment conditions, and upon its requirement to deposit a sum immediately as a guarantee that devisen proceeds of exports would be duly surrendered. An exception was made for sales in terms of Schillings against foreigners' Schilling accounts in Austria. Official approval of the Bank was required also for lending or borrowing abroad or for making payments of principal, interest, dividends, etc. abroad in foreign money. Finally, the National Bank was granted access to all business book-keeping and correspondence, and extreme penalties were enacted — a maximum 250,000 Schillings fine for the first offense and double this sum and imprisonment up to five years for the second offense. Any bank violating the statute might have its charter revoked.

No sooner was the legislation enacted than its defects began to appear on the one hand an intolerable severity, and on the other the possibility of legal and illegal evasions. Three days after the act was promulgated, exporters and transit firms received authority to retain devisen necessary for purchasing raw materials and goods for re-export, though documented accounts of all such transactions had to be rendered the National Bank. Furthermore, foreign balances of insurance companies and banks for correspondent purposes were released by decree on October 15. Minor amendments were incorporated into a Second Devisen Act passed on October 16, and on November 18 there was promulgated a Third Act designed to strengthen the hand of the National Bank. The law failed signally, however, to stop evasion through purchase of foreign securities and through export against Schilling accounts of foreigners. The first law had made obligatory the sale to the Bank of foreign balances with credit institutions only, now the obligation was extended to foreign balances with any agency. A further clause prohibited the sale of domestic gold and silver currency at a price exceeding its nominal value.

The final legislation, the Fourth Devisen Act of January 4, 1932, explicitly limited exports against foreigners' Schilling deposits to accounts which originated before October 9 or were especially designated as "free" by the National Bank. The bare legal framework of exchange control as evolved in the four Devisen Acts was complemented by intricate administrative measures. Under the authority of these laws, the Austrian National Bank concluded clearing agreements with Hungary, Italy, Switzerland and Jugoslavia in the four months of attempted government monopoly prior to February, 1932. Simultaneously a system was being slowly and haltingly worked out for the rationing of devisen.¹

1 With the majority of exchange control countries, the Austrian authorities attempted to lighten the task of the central bank itself through two devices — a certificate system, and a preliminary examination of demands for devisen, both with the cooperation of the Chamber of Commerce. Immediately after the First Devisen Law the National Bank empowered the Chamber to grant to exporters of known standing certificates or attestations which permitted them to retain devisen proceeds for essential imported raw materials. The system seems to have been administered with too open a hand, on January 9, 1932, a census revealed 1,700 licensed firms, and the Bank was moved to a vigorous reduction of their numbers.

Although the imposition of exchange control had been impending for several weeks by the time of its actual adoption, the National Bank, caught without provision for its heavy duties, could attend to only a mere fraction of the applications for devisen. A first step in simplifying matters was the complete stoppage of rationing for certain import categories. The Bank also fostered a system of Advisory Councils, the first one being created for the shoe and leather industry on October 28, subsequently there were extensions to metals, wood, resin, and glass. Although the Councils were designed to represent and adjust the divergent interests of manufacture, trade, and commerce, they functioned poorly and had to be supplanted by another system.

As early as November 15 there were established in the Austrian National Bank twelve administrative divisions, corresponding to an equal number of important groups of industries for the allocation of devisen. At first these divisions attempted to carry on the work in the Bank alone, but by the end of November the task of dividing out this allowance amongst individual applicants was left to complementary agencies called Vorprüfungsstellen. These preliminary examination boards were not fully established before the really active period of control terminated. The first one, organized on November 30, controlled bread-cereals and fodder, and during December and January similar units were created for industrial raw materials, fertilizers and textiles. One unit existed quite outside the Chamber of Commerce—the Vorprüfungsstelle in the Ministry of Agriculture. Its isolated position gave rise to recriminations, because in the later developments, when industry generally had to purchase devisen at the free market price, farming interests still received substantial rations of exchange at the official par. (Of Arbeiter Zeitung, June 21, 1932, Neues Wiener Tagblatt, November 28, 1932.) The impression prevails even with high authorities in the Bank and the Ministries that allocation proceeded in all quarters by high-handed and arbitrary methods.

THE EFFICACY OF CONTROL

Despite the heavy administrative apparatus, the attempt between October 9 and early February to make government control of exchange effective began unpropitiously and ended in fiasco because of widespread evasion, illegal and legal. Black market dealings in exchange flourished at all times in the Vienna cafés. Notwithstanding all prohibitions, a lively traffic in domestic currency sprang up in the Austrian border villages, and the National Bank withdrew the issue of 1,000 Schilling notes (cf. Fig. 2, p. 32) which had facilitated smuggling. Illegal, also, but widespread, was the practice of having foreign sellers bill the Austrian importer for a spuriously large amount, subsequently utilized as an excessive claim for devisen allocation. A favorite device, utilized extensively until as late as 1937, was to arrange to be billed for an import f.o.b. the foreign city of origin, whereas actually the importer had really to pay only f.o.b. Austrian border. Another ruse, even more extreme, was to induce foreign firms to send to Vienna their printed blanks for billing customers, or even to found in a foreign city a holding company to originate billings for goods which had never been imported. Firms within Austria enjoying the privilege of retaining export proceeds for the purpose of importing raw materials for re-export or for fabrication and re-export used receipted import-duty bills in conjunction with these spurious billings to secure devisen allocations which could then be applied to capital flight. During the period following the Third Devisen Act, when exports against payments in blocked Schillings were commonly thought to be legalized, exporters drew bills upon foreign purchasers for payment in blocked Schillings, secretly arranging for payment in devisen, which thus escaped control.

It is surprising, however, that illegal evasion should have been resorted to at all, in view of the many possibilities within the law. Most important amongst these were the so-called "export against Schillings" and the purchase of foreign securities. Both these modes of evasion were facilitated by the anomalous position of legal trustees under the Devisen Acts. On a slightly different level were the virtual evasions through purchasing goods on credit and through the clearing system.

The question of "exports against Schillings," i.e. whether Austrian producers should be permitted to sell for payment, not

in devisen, but merely in Schillings transferred from the otherwise frozen account of a foreigner in an Austrian bank, was hotly mooted in the press. Commercial organizations, on the one hand, maintained that the export industries could sell at competitive prices abroad only by accepting the (depreciated) blocked Schillings in payment, and they pointed to a further gain in this reduction of Austria's commercial indebtedness.¹ Officials of the Bank, on the other hand, maintained that the practice simply removed the control of imports from their hands and permitted a speculative market on blocked Schillings abroad, a market said to be narrow and subject to disastrous price declines from small decreases in demand. To the degree that blocked Schillings were accepted in payment of exports, the inflow of free devisen to the Bank was cut off. Furthermore, the officials and their supporters argued, when exchange control was imminent many Austrians had transferred their bank accounts to foreigners in order to be able to send funds out of the country later. To permit their utilization now for exports would be to complete the intended capital flight by means of real goods.

What the spirited journal discussions apparently missed was that this question involved not simply a particular practice but the whole matter of exchange control. The advantages to exporters cited by proponents of "export against Schillings" were real enough, but, after all, the "advantage" of reducing the commercial debt was precisely what exchange control was designed to prevent. President Kienbock pointed out that he later permitted this mode of payment merely as one way of withdrawing from the system. So long as exchange control was to be enforced, however, it is clear that the National Bank was right in opposing "exports against Schillings."²

1 Cf. the Sofortprogram of the Chamber of Commerce of Vienna in its *Geschaftsbericht über den Monat März, 1932*, also the demands of the two leading industrial and commercial organizations in Austria in the *Neue Freie Presse*, February 6, 1932.

2 Execution of this decision was seriously crippled by two defects in the Devisen Ordinances. For one thing, whereas the First Devisen Act (Sec. 5) authorized the National Bank to require of exporters a promise under oath to deliver export proceeds, if payment were taken in foreign devisen, a mere notification of the Bank by the exporter was sufficient, if payment were taken in foreigners' *free Schilling deposits*. But Section 5 of the Third Devisen Act (November 18) omitted mention even of the notification; this circumstance led to the popular impression that the bars had been let down to "export against Schillings," though the omission was really a "joker" perpetrated by interests

Another peculiarity in the ordinances was that only credit institutions were prohibited from transferring foreigners' accounts to others without the permission of the Bank. Until the Fourth Devisen Act expressly extended the prohibition to all agents, hundreds of attorneys drove a lucrative business with impunity by acting as trustees for foreigners and transferring accounts to third parties.

A second main channel of legal evasion was the purchase from abroad of internationally traded securities. Under the exchange prescriptions, the seller of a foreign security outside Austria could be paid in "inland" or blocked Schillings, and these sums could legally be invested in domestic securities, real estate, or by permission be applied to exports. To the degree that blocked Schillings were actually utilized by foreigners there could be no damage to the foreign value of the Schilling, aside from cases in which the foreign purchaser would otherwise have taken the Austrian goods or titles even for payment in free devisen. If, however, the proceeds of the sale were simply left in blocked accounts, their growing magnitude drove down quotations on these Schillings to lower and lower levels.

By the end of October, 1931, the Vienna quotations on Austrian League of Nations bonds and the International Federal Loan stood 20 per cent above the foreign quotations. A heated discussion arose in the press as to the desirability of following Czechoslovakia, Germany, and Hungary in requiring the sale of privately held securities to the government. The proposal was stigmatized as a squandering of the national wealth, especially, it was said, as Austrians held a much higher proportion of their wealth in foreign securities than the nationals of other exchange control countries. Actually the proposal was not incorporated into the Third Devisen Act as the public had feared, and even the Fourth Devisen Act prohibited merely the acceptance of foreign securities in payment for exports. The purchase of foreign securities continued to be a opposed to the control system. A reduction of foreigners' Schilling deposits by 29,000,000 Schillings from November 30, until the Fourth Devisen Act definitely concluded the practice for the time being, explains fully one-seventh of the adverse balance on capital account during this interval. The figure of 29,000,000 Schillings actually includes the four months period from November 30, 1931, to March 31, 1932. Cf. Rost van Tonningen, *Fourth Quarterly Report* (November 30, 1932), p. 9. It is fair to assume, however, that most of it is accounted for in the limits given above.

mode of capital flight long after exchange control in other respects had been abolished, and not until April 5, 1933, did the Finance Ministry prohibit dealings in certain Swiss railway bonds which had become favorites. By this time the practice had become so deeply imbedded that the demand simply switched over to Swiss stocks, English consols, and various war loans.¹ The proposal to prohibit purchases of foreign securities, or to end the practice by compulsory sale to the government was a logical complement to the compulsory sale of devisen. The failure of the Austrian devisen acts to embrace this category of international credit instruments resulted in a direct channel of capital flight.

Besides these types of evasion in a strict sense, the existence of clearing agreements and the practice of selling to Austrians on credit operated to remove control over imports from the National Bank. It may, of course, be argued that even "superfluous" imports derived in either way do not make any *current* claim upon devisen. Nevertheless, since clearing balances have eventually to be met, and since foreign short-term credits come eventually to an end, such imports represent an eventual burden upon the country's exporting and paying capacity. The Austrian Institute for Business Cycle Research estimated sales on credit from October, 1931, to April, 1932, at 200,000,000 Schillings, or nearly half the total excess of imports over exports of 417,700,000 Schillings in the same period.

The net result of the late introduction of exchange control and the lax administration and evasion of the law was its almost complete failure to secure the devisen yielded by exports. When toward the middle of November, 1931, the National Bank published returns for the first month of control, it transpired that devisen receipts had amounted to 86,000,000 Schillings, of which 65,000,000 Schillings came from stocks of devisen already in private hands on October 9 and surrendered in conformity with the requirement. Only 20,000,000 Schillings had been produced by the flow of exports, although their total had aggregated more than 100,000,000 Schillings in that month. The discrepancy of 80,000,-000 Schillings was partly accounted for by legal exemptions for raw material imports under the certificate system. Furthermore, the owners of certificates often obligingly handed over their received customs bills, as evidence of actual importation of raw materials,

1 Die Borse, June 29, 1933.

to persons desirous of documenting a claim to devisen allocation, perhaps only for purposes of exporting capital. Inasmuch as imports of raw materials amounted to only about 30,000,000 Schillings, and not even all of this was covered by certificates, it is clear that a minimum of 50 per cent with the probability of something approaching 65 per cent of devisen receipts legally or illegally evaded control.¹ The result was that even by the end of the first week in November allocations of exchange did not exceed 3-4 per cent of demand.²

CLEARING AGREEMENTS IN THE PERIOD OF ATTEMPTED MONOPOLY

The history of Austrian clearing falls into two phases, the first extending from late December, 1931, to the spring of 1932, the second extending to March, 1932. During the former phase, while Austria imposed sharp restrictions on all foreign payments, the introduction of clearings proceeded on foreign initiative, whereas in the latter period, while Austria relaxed exchange control, she was forced to rely upon clearings to secure payment for exports to control countries. Another very significant difference between the two episodes of clearing was the use of gold par in the former and a rate approaching free market quotations on the Schilling in the second. The Austrian attitude itself underwent a complete reversal. The earlier president of the National Bank, Dr Reisch, had enthusiastically supported clearings at a conference sponsored by the Bank for International Settlements in Prague on November 2 and 3, 1931, by the end of December, he announced with evident satisfaction, that ten agreements were

1 Der österreichische Volkswirt, November 12, 1931, pp 181-182.

2 On January 1, 1932, the Bank reported as follows upon the period October 9 to December 31, 1931: devisen received, 185,300,000 Schillings, devisen paid out — for the state debt and government needs, 53,600,000 Schillings, for the service of other loans, 13,900,000 Schillings, for commercial purposes, 109,300,000 Schillings, a total of 176,800,000 Schillings. (Cf Rost van Tonningen, Second Quarterly Report, May 2, 1932, p 10.) The total receipts of 185,000,000 Schillings represent not only the entire devisen yield from 280,000,000 Schillings exports, but also from the compulsory sale of existing stocks at the outset! By the end of January, 1932, allocations amounted to 1-1½ per cent of demand. The fact that the first four weeks of control produced 85,000,000 Schillings in devisen receipts, whereas the next eight weeks yielded only 99,000,000 Schillings, is explained by the absorption of stocks in the earlier period and by the growth of "export against Schillings" in the second.

completed or in process of formulation¹ But his successor, Dr Kienbock, regarded clearings as a defensive instrument only, and proceeded to liquidate the agreements with free exchange countries as fast as Austria herself could reduce the obstacles to international payments²

During the first period the National Bank put into operation agreements with Switzerland on December 11, Hungary on December 14, 1931, Italy on January 10, and Jugoslavia on January 20, 1932. The French clearing initiated on May 1 has also to be included with the earlier agreements by virtue of the par Schilling rate. In general these clearings followed the pattern of the Swiss agreement, which was the first of its kind anywhere, but they did not include its provision that one-third of the Austrian proceeds had to be applied to the service of non-commercial debts. The Hungarian clearing was peculiar in that, wheat exports to Austria being paid for in free devisen and the pengo and Schilling being about equally depreciated in terms of gold, payments approximately balanced off throughout this period and indeed, with occasional inequalities, through June, 1935. This clearing must therefore be excepted from the following generalizations.

No sooner had these early agreements been put into force than their perverse effects began to appear. The overvaluation of the Schilling sharply reduced exports and stimulated imports, and the National Bank automatically lost control of imports. As Dr Robert Bieza has pointed out,³ instead of essential raw materials for domestic consumption or fabrication and re-export, Italian fruits and early vegetables and Swiss clocks came into the country. Since clearing stopped the flow of devisen to exporters, they lost the benefits of certificates permitting retention of devisen for imported raw materials, they had therefore to depend on the meager Bank allocations. Austria was caught between the upper and nether millstones exports to Switzerland and Italy, which had formerly brought in devisen on balance, now resulted only in franc and lira clearing balances, whereas with Hungary it was necessary to pay for the indispensable wheat imports with devisen. Furthermore, Austrian exporters had every reason to attempt to obtain payment *outside* the clearing with free currency countries.

1 Die Borse, December 24, 1931

2 Kienbock, op. cit., p. 385

3 Neues Wiener Tagblatt, December 25, 1931

such as Switzerland and France, while Austrian importers from weak currency countries profited by utilizing the clearing. In consequence the clearing balance took an even more unfavorable turn than the balance of trade.

In January and February, 1932, exports dwindled to an unprecedented low level of 61,000,000 Schillings and 66,000,000 Schillings, during the first quarter of the year gold and *devisen* reserves fell from 318,000,000 to 215,000,000 Schillings. Unliquidated clearing balances with partner countries mounted meanwhile to such appalling sums with the Austrian National Bank that the whole system had gradually to be recast. On March 10, Austria denounced both the Swiss and Italian agreements, upon which balances of 9,000,000 and 19,000,000 Schillings had accumulated, and on March 22 Jugoslavia denounced the existing agreement, though a renewal carried on the old parity clearing until October 5, with an accumulation of 10,000,000 Schillings against Austria. The French clearing represented a distinct anomaly in being introduced on May 1 with the parity rate, it persisted, however, until June 17, 1933, with an unfavorable balance to Austria of 10,000,000 Schillings. At the end of 1932 the total of Austrian short-term commercial debts had risen by 100,000,000 Schillings, largely through adverse clearing balances.¹

Except in one case the liquidation of these balances proceeded painfully and with numerous bickerings as to rapidity of payment and rates of exchange applicable to old debts. The introduction of a 12 per cent premium on Schillings in Jugoslavia between October 5, 1932, when this country denounced the clearing, and October 20, when the agreement actually ceased, enabled the Austrian National Bank to pay its entire debt within the fortnight. In all cases the repayment had to be effected by a retroactive levy upon Austrian importers who had utilized the clearing during the period when the indebtedness accumulated. Not until May, 1933, was the Swiss balance liquidated, and the process continued until September, 1933, and February, 1934, respectively, for the Italian and French balances. Liquidated clearing agreements were not renewed during the remainder of Austria's independent existence, and after the spring of 1932 the clearings — restricted to countries with exchange control — proceeded, with the exception of Hungary, until late in 1935, on the free market value of the Schilling.

1 Oscar Morgenstern in the London Times, July 20, 1937, p. 18.

HOW AUSTRIA ESCAPED FROM EXCHANGE CONTROL
FEBRUARY, 1932-MAY, 1935

Austria's withdrawal from all but rudimentary exchange control constitutes a unique chapter in monetary history. The eventual official recognition of Schilling depreciation, which had always been contemplated as a calamity, scarcely aroused a word of comment even in financial circles, and the general public remained happily ignorant of the fact. How this could be is explained by two circumstances — the general decline of world gold prices, which permitted virtual devaluation without an absolute rise in domestic prices, and, secondly, the gradual and adroit adoption of the new currency basis by the National Bank under Dr. Viktor Kienbock. At his succession to the presidency of the Bank on February 5, 1932, the allocation of devisen was approaching zero as a limit, and the trade balance had become extremely passive. The first subtle approach to liberating payments began with the Bank's permitting Austrian exporters of wood products, including lumber, paper, pasteboard, and cellulose, to sell their devisen at rates privately agreed upon to importers of mineral oils. Exports of the categories mentioned languished because pound-sterling devaluation had cut off important markets, on the other hand, imports of mineral oil could easily bear the higher rate on devisen because there was no competing domestic production. Another commodity showing substantial importers' profits was oleomargarine, and this the National Bank paired off with butter, which like wood products could legitimately be assumed to embody a weak "comparative advantage."

The coupling of specific exports and imports came by degrees to be extended further — to hats and leather exports against imports of grain and fodder, pharmaceutical products, and textile raw materials. In Austria, however, contrary to the later practice in Hungary, exchange rates in these cases were never determined by the National Bank, but solely by pairs of contracting parties. Consequently the quasi-free market in Vienna was always designated as "private clearing." It should not be imagined that this market, particularly in its beginning stages, gave free rein to competitive forces. For many months the express permission of the National Bank was necessary for each single transaction, with the result that small traders found themselves relatively handi-

capped. In all cases the commodity prices had to include, besides fairly high commission fees, a premium for the risk of not securing official permission. Equally important was the "raw-material quota," a requirement that even when admitted to private clearing, the exporter should surrender to the National Bank at its official price a certain percentage of his devisen, at first really, later on only ostensibly, to permit the Bank to continue certain allocations of devisen at par for "indispensable" imports. The quota was levied differentially amongst various categories of exports according to country of destination and the Bank's estimate of profit margins. Until late in 1932 the fiction was maintained that an export had to be "additional" to be eligible for admission to private clearing, and, finally, only transactions involving visible exports and imports could be admitted at all. As might be expected, the isolated pairing of exporters and importers, the differential character of the "raw-material quota," and the delays and restrictions involved in official permission resulted at first in a welter of quotations for one and the same foreign money.

The advent of private clearing also opened channels of evasion of exchange control generally. Raw materials could be imported for certain industrial purposes duty free. With the custom papers in hand, an importer could secure permission to purchase foreign devisen on the private clearing to satisfy his foreign creditor. Thereafter nothing prevented his also re-exporting the raw material and securing foreign devisen a second time, which could then be used to export capital.

Once begun, the relief to exporters and importers through the private clearing sufficed to insure its increase and elaboration. The Austrian National Bank on July 17, 1932, designated the Wiener Giro- und Kassenverein, a bankers' organization which had long existed as a clearing center for bank balances and a depository for securities, as the official agency for private clearing. From this point forward, as the statistics show, the turnover of private clearings grew steadily until, toward the middle of 1933, it reached a level set by the visible trade of Austria minus payments

TURNOVER ON THE PRIVATE CLEARING
(Million Schillings)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec		
1932										56 8	90 0	102 3	130 7	119 3
1933	113 6	119 6	164 8	159 1	204 5	181 8	187 5	164 8	187 5	227 3	244 3	204 5		

escaping control or passing over the remaining clearing and compensation agreements Circumstances combining to produce this evolution were four the termination of clearing agreements belonging to the "first period", the attenuation of devisen rations by the Bank and its designation of further items of payments to be covered in private clearing, the reduction, eventually to zero, of the raw material quota, and, finally, the progressive liquidation of frozen accounts, so that virtually all payments passed over the free market

The accompanying table reveals not only the striking fact that from October, 1931, to December, 1932, nearly 70 per cent of all imports were either purchased on credit or withdrawn from central bank control through evading the official channels of payment, but also that by October, 1932, the allocation of devisen had reached negligible proportions During the course of that month allocations for agricultural imports such as fodder, seed, and wheat, beside raw material for textile manufacture, were stopped With the decree that foreign exchange for purposes of travel abroad after November 21, 1932, should be derived from the

AUSTRIAN IMPORTS AND AUTHORIZED IMPORT PAYMENTS*

Period	Allocations Granted by National Bank for Imports and Sundry Commercial Purposes	Settled by			Imports to Austria
		Inter-State Clearing	Private Clearing	Schilling Compensation	
(in millions of Schillings)					
1931					
October-December	108 4	0 4	—	—	332 7
		(December only)			
1932					
January-March	79 4	38 8	38 8	50	394 6
April-June	44 7	42 4	42 4	—	364 —
July-September	23 3	39 1	39 1	18 (From 12 July 17)	312 1
October	3 4	20 1	20 1	9	107 3
November	0 8	18 5	18 5	11	108 5
December	0 5	14 5	14 5	14	117 —
Total	260 5	173 8	173 8	52	45
					1,736 2

* Payments abroad converted at parity rates including payments effected by the National Bank in foreign exchange under the Jugoslav clearing Old Debts account and under the Hungarian clearing Wheat account excluding payments under the Bulgarian and Greek tobacco clearings and for the debt service of the Swiss clearing This table is reproduced from Rost van Tonningen Fifth Quarterly Report (February 24 1933) p 8

private clearing market, allocations for all private purposes ceased. Meanwhile, because of the violent protests of the export interests, the "raw-material quota," which had stood as high as 40 per cent and even normally had varied from 20 to 15 per cent, was reduced to 12 per cent. On December 6 the final step in this direction was taken with the complete abolition of the quota.

Austrian importers still had to pay extra amounts over the clearing rates in order to liquidate the adverse balances with France, Italy, Rumania and Switzerland. Not until April 6, 1933, did the National Bank formally suspend its right to pass on transactions to be admitted to private clearings, the same decree also terminated the formal obligation of Austrian citizens to surrender devisen to the Bank at its official price. This eliminated an anomaly which had persisted from the end of the "raw-material quota," namely, that whereas ordinary exporters received the free market value for their devisen, the low official price was still applied to devisen received by authors, patent possessors, annuitants, and dependents.

Intimately associated with the disappearance of devisen rationing, compulsory sale of devisen, and the "raw-material quota," were two other processes contributing to the slow evanescence of exchange control in Austria — the liberation of certain frozen accounts, and the cautious and piecemeal official recognition of devaluation. The new Bank regime, in recognizing that future stability of the Schilling could be jeopardized by the presence of Austrian *Sperrkonti* on foreign markets, immediately took steps toward their liquidation. On March 9 the banks were authorized to honor drafts against frozen accounts up to 1,000 Schillings monthly for each owner for travel in Austria. On April 22 all blocked accounts — estimated at 10,000,000–12,000,000 Schillings — accumulated between October 12 and December 3, 1931, were converted into "free" accounts, applicable to a variety of domestic uses and to exports. The measures of May 2, 18, and 25, June 22, 1932, and January 21, 1933, liberalized the use of blocked accounts for travel in Austria. Blanket permission to receive payment for export in Schillings, regardless of date of contract and currency originally stipulated, was extended on October 20, 1932, provided that (1) 12 per cent of the bill was paid in foreign devisen, (2) the payment was for commercial purposes, and (3) the export proceeded to the country where

the account was owned. The export stimulus of this measure was somewhat dampened by the 12 per cent "raw-material quota", but six weeks later, as we have seen, it too was removed. The monthly reductions of foreigners' Schilling accounts in consequence of these measures can be traced in the following figures

CHANGES IN FOREIGNERS' SCHILLING ACCOUNTS*

(In Millions of Schillings)

(Estimates)

From	To	Free Inland Schilling Accounts	Blocked Schilling Accounts
Nov 30, 1931	Mar 31, 1932	-29 0	+ 2 1
Mar 31, 1932	June 30, 1932	-11 3	-11 0
June 30, 1932	July 31, 1932	- 4 0	- 1 0
July 31, 1932	Aug 31, 1932	- 2 5	- 4 3
Aug 31, 1932	Sept 30, 1932	- 1 2	+ 0 8
		—	—
		-48 0	-16 4

* Rost van Tonningen Fourth Quarterly Report (November 30 1932) p 9. Cumulative figures have not been made public and the monthly statistics given do not include accounts with other agencies than banks.

The manifold and practically free uses of blocked Schillings are reflected in the fact that by June, 1934, their quotation on the Zurich market stood at 55 for 100 Swiss francs, while ordinary Schilling exchange stood at 56-57.

By the end of 1932 the most rigorous features of exchange control had vanished. Ordinary trade proceeded entirely over the private clearing, the early gold-parity clearings were being liquidated, compulsory sale and the rationing of devisen were both in a state of desuetude, and the frozen accounts were being rapidly reduced. Why, then, was exchange control not completely abolished? Beside several reasons to be examined later, two appeared with particular cogency. To permit a small handful of directly concerned traders to deal in paper Schillings at a discount is, in the first place, a vastly different matter from playing with the fire of panic psychology by making a general public acknowledgment of depreciation. Secondly, a large amount of domestic debts in terms of foreign currencies, the so-called *Valuta-Schulden*, presented an almost insoluble problem.

The Austrian Supreme Court on March 23 and April 26, 1933, took the first legal step, in contrast with the foregoing purely administrative measures, in recognizing devaluation by upholding the validity of gold contracts. Supplementary cabinet decrees at

the same time proclaimed that contracts for effective gold payment would be revalued according to the quotation of Schillings on the private clearing market, but leaving the precise date of the relevant quotation for future settlement. The actual valorizations subsequently enforced through taking the quotation "as of" different dates varied widely amongst the several types of obligations. Owners of bank deposits, for example (the holders of *Kassenscheine*), were allowed an effective premium of 10 per cent by decree of November 14. But owners of agricultural mortgages, though their paper was revalorized by 25 per cent, or almost to the full 28 per cent premium which had eventually established itself on gold currencies, actually received nothing because the interest was reduced reciprocally, so that mortgages simply continued at their old prices. Repayments on dollar and pound foreign loans into the special account for this purpose with the Bank had to be made at the full private clearing rate after August 28, 1933, and this was extended to all foreign loans after January 1, 1934. Another stage in the gradual recognition of devaluation was reached on April 30, 1934, when the Austrian National Bank revalued its gold reserves at 6,000 Schillings to the kilogram, in place of the old rate of 4,715 Schillings (cf. Fig. 1, p. 31), bringing about a correspondence with the 128-100 ratio of paper to gold Schillings, or a devaluation to 78.2 per cent.¹ Not until December 21, 1934, were possessors of bank deposit-books and "current accounts" allowed the full private clearing rate on their claims, totalling 10,000,000 Schillings. The obligations of industry to the banks were not settled, nor was the last step in legal devaluation taken, the redefinition of the Schilling in gold.

LIQUIDATION OF DEBTS AND THE SITUATION PRECEDING INCORPORATION INTO GERMANY

To appreciate the desperateness of the Austrian situation in 1932, when effective exchange control had already been abandoned, but before the "automatic correctives" through prices and exchange rates could operate, we must return to the foreign debts. During 1931, 1,000,000,000 Schillings had been withdrawn from the country, a sum equal to the entire amount of short-term foreign

¹ The "profit" of 20,700,000 Schillings financed the reorganization and fusion of the Credit Anstalt, the Wiener Bankverein, and the Niederoesterreichische Escomptegesellschaft in the Spring of 1934.

obligations of Austrian banks in May, 1931¹ Over the year, also, gold and devisen reserves had declined from 930,000,000 to 318,-000,000 Schillings The Bruns Agreement, covering 240,000,000 Schillings of short-term bank debts abroad in August, 1931, was renewed for the balance of 114,000,000 Schillings on January 20, 1932, for six months with a complete standstill on principal and interest Even so, with a remaining debt service of 23,000,000 Schillings monthly, devisen reserves sank by 20,000,000 Schillings a month during February and March, and before the Transfer Moratorium in July, 1932, by a total of 114,000,000 Schillings, or by more than a third of the 318,000,000 Schillings in reserves which had survived to the beginning of 1932

I have already remarked upon the appeal for a loan directed by Austria on August 9, 1931, to the League After consultation with the Financial Committee the government enacted a budget reform on October 3, and on the 15th secured a three months extension of advances made by the Bank for International Settlements and the Bank of England during the Credit Anstalt crisis The Financial Committee was unable to stir the League to action upon a loan, and on May 9, 1932, Austria sent a second petition Heavy maturities impending at the end of the month, together with the failure of Austrian bankers and British and American creditors to agree on the standstill arrangement expiring on July 20, forced the government to a provisional moratorium on June 23, 1932

On July 15, the very date of the Geneva Protocol which finally indicated the willingness of the Powers to extend a loan, the formal Transfer Moratorium had to be proclaimed Excluding 332,000,000 Schillings in trade debts, all foreign obligations fell under the decree — 3,200,000,000 Schillings in principal with an annual service of 247,000,000 Schillings¹ Henceforth all payments owing abroad were made into a Foreign Debt Fund with the National Bank, out-payments to creditors were permitted on two conditions (a) that the creditor agree to employ the proceeds for Austrian real estate and securities, for exports, or for services and travel within the country or (b) that the Bank give express permission for payment in devisen At first in-payments proceeded

¹ Rost van Tonningen, Fourth Quarterly Report (November 30, 1932), pp 14-15 The figure does not include the Schilling accounts of foreigners or trade debts in Schillings

only at the official exchange rate, but later the private clearing rate was applied. The total accumulation in the Foreign Debt Fund amounted to 55,000,000 Schillings at the end of September, 1932, and 88,000,000 Schillings at the close of the year. Though limited transfer was resumed on January 1, 1933, the total rose to 108,000,000 Schillings at the half-year. Several factors precipitated a fall to 17,000,000 Schillings three months later; the Bank allowed freer use of the blocked Schilling accounts, many foreign creditors accepted payment in Schilling balances and utilized them in the country, and private arrangements for postponement or settlement increased in number. From September, 1933, to May, 1935, the Fund dwindled from 17,000,000 to 8,000,000 Schillings, and at this point the Bank was able to authorize complete transfer on all funded foreign liabilities.

When allowance is made for the underwriting of the Credit Anstalt, Austria experienced a relatively small increase in public indebtedness, a fact which contributed substantially to the strength of the Schilling.¹ Foreign indebtedness included under the original Standstill Agreement amounting to 295,000,000 Schillings (in devalued Schillings) was reduced by 230,000,000 Schillings at the end of 1933, and on December 10, 1934, was completely extinguished. It was not until two years after Austria's first plea to the League and a year after the Geneva Protocol that the Austrian Government Guaranteed Loan (1933-1953) was finally floated, in August, 1933. The yield of 237,400,000 Schillings enabled the Bank to repay the 100,000,000 Schillings credit from the Bank of England and 90,000,000 Schillings from the Bank for International Settlements, prolonged at six-months intervals since July, 1931, and to liquidate 50,000,000 Schillings arrears on the 1923 League Loan and the Federal Loan of 1930. Dollar devaluation accounted for 568,000,000 Schillings of a total foreign debt reduction of 1,059,700,000 Schillings between 1932 and 1933, and the devaluation of the franc and other currencies in 1936-1937 contributed 42,000,000 Schillings. An important event of 1934

1. The absorption of Credit Anstalt liabilities from the Austrian National Bank accounted for an increase of the public debt from 2,077,400,000 Schillings at the end of 1931 to 2,613,000,000 Schillings at the end of 1932. By the end of 1933, the figure had risen slightly to 2,711,700,000 Schillings, or to 3,471,100,000 Schillings when account is taken of devaluation. In the closing months of Austria's independent existence, the public debt stood at 3,900,000,000 Schillings.

was the conversion of the 1932 League of Nations Loan from interest rates of 6, 6½, and 7 per cent to 4½ per cent, completed by December 1, with a consequent reduction in Austrian foreign liabilities of 80,000,000 Schillings. In consequence of these favorable developments, foreign indebtedness was reduced over the entire period by 56 per cent.

AUSTRIAN FOREIGN DEBTS IN FOREIGN CURRENCIES*

(Year-end figures in million Schillings)

	1932	1933	1934	1935	1936	1937
Bonded indebtedness	2,574 6	2,542 3	2,002 2	1,928 7	1,707 1	1,592 7
Long and middle term debts	389 0	360 1	343 2	353 5	256 0	241 7
Short term debts	1,287 4	378 9	244 6	147 7	100 1	46 0
Total	4,251 0	3,191 3	2,590 0	2,429 9	2,063 2	1,881 3

* Data from The Austrian National Bank in Liquidation as given by the Berichte of the newly constituted Wiener Institut für Wirtschaft und Konjunkturforschung Jhg 12 Nr 9-10 p 230

The complete consolidation of foreign debt and substantial improvement in all capital accounts gave to Austria an enviable position amongst European debtor countries. During 1936 and 1937 Austria was unique in being able to secure again short-term commercial credits on the London market. It has been hinted in responsible quarters that a substantial amount of the repayments just recorded proceeded by evasion of exchange control laws with the tacit consent of the National Bank, which could be pardoned for having had this regard for Austria's credit standing.

Undoubtedly the Schilling was put to severe test by the gold-bloc and attending devaluations in late September and October, 1936. Some foreign observers thought that Austria was the most seriously threatened of all other countries, and within the country certain vested interests, industrial exporters, for example, warmly espoused devaluation. Over 27 per cent of Austrian exports and 19 per cent of imports were involved with Italy, Switzerland and Czechoslovakia, when these countries devalued in 1936, and other devaluations since 1931 had considerably exceeded the 22 per cent Schilling depreciation. On October 8, however, the government announced that the existing Schilling would be maintained. Austria, according to the Finance Minister and the Central Bank President,¹ could not risk the social consequences of a price revolution nor could she meet the first shock of devaluation.

1. In my judgment, a small additional devaluation would have had beneficial effects on balance.

with her available capital reserves. Embracing only a small part of demand on international commodity markets, she could not possibly reduce the level of gold prices by devaluation, but the Schilling prices of imported raw materials and foodstuffs would rise instead. It would be impossible to compensate for this tendency by lowering import duties and thus abruptly exposing domestic producers to foreign competition.¹

That the Schilling successfully weathered the foreign devaluations of 1936 is attributable not only to the moderate growth of the Austrian public debt and the reduction, consolidation and servicing of foreign debts, but also to three factors of immediate relevancy. So far as concerns imponderable psychological matters, the Schilling market was undoubtedly affected favorably by the spontaneous termination of League oversight of her finances on November 1, *after* the announcement that the Schilling would not be devalued, and furthermore the very definiteness of this announcement, coupled with the reputation for firmness on the part of the central bank president, reassured the public. Thirdly, so far as concerned the quantitative determinants of trade, Austria secured advantages in both the regulated and free sectors. In the former, several trade agreements were modified to permit larger exports, and in the price-determined sector, for the first time since 1929, foreign determined prices, as may be seen in Fig. 4, overhauled the advance of domestically determined prices. Whereas foreign prices advanced sharply under the influence of recovery and rearmament, Austrian prices were restrained by conservative central bank policy and by the isolation common to countries involved in clearings, quotas, and import prohibitions. After March, 1937, domestic prices again moved along a substantially higher level than prices determined abroad, but the devaluation crisis was then water under the bridge and Austria could safely oppose the general scramble for liquidity.

Definite evidence of the success of the currency policy came with the flotation on February 6, 1937, of the Domestic Investment Loan of 180,000,000 Schillings. Without gold or gold-value clauses characteristic of previous loans, and with an effective yield substantially below even the depression-period loans of 1933 and 1935, ninety per cent of this issue was absorbed by the general

¹ League of Nations, Austria Public Finances, First Report (Geneva, 1936), pp. 10-12.

public with extensive participation by small savers¹. The loan indicated the solid position of the Schilling, but it also contributed to stability through consolidating short-term Treasury debts, improving government industrial holdings, and indirectly increas-

AUSTRIAN PRICES SINCE 1929*
(LOG SCALE, 1929=100)

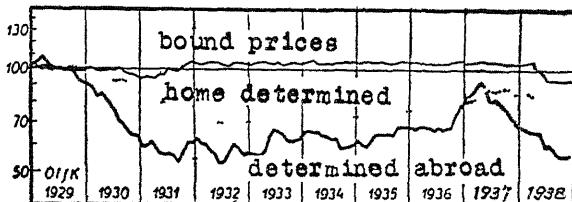


FIG. 4

* O I f K, Jhrg 11, Nr 4, p 79. The figure has been extended through February, 1938. For statistics, cf pp 78-80.

ing the liquidity of the National Bank. Gold and devisen reserves of the Bank equalled 34.2 per cent of its notes and deposits in February, 1938, or almost exactly double the reserve ratio at its low point in December, 1932.

Nevertheless, the exchange control laws were never revoked, and some of their provisions were still enforced, such as the blanket prohibition, except to owners of exporters' certificates, of remitting abroad without permission of the National Bank. This included, beside payments on old obligations, remittances for travelling, for relatives abroad, and for imports in the transit trade. What had been achieved was, in fact, the "simple exchange control to prevent capital flight" advocated as early as December, 1931, in mercantile circles.²

A peculiar irony forced Austria, despite her own withdrawal from exchange control, to extend her clearing system because of developments in neighboring countries. On August 10, 1934, Austria entered for the first time into an agreement with Germany to cover the whole field of trade by clearing, the chief German export being Ruhr coal against Austrian agricultural products. After two years of fairly satisfactory functioning, this clearing

¹ League of Nations, Austria Public Finances, Second Report (Geneva, 1937), p 4.

² E.g. by the eminent Vienna merchant Julius Meinl, an ardent liberal. Cf Neues Wiener Tagblatt, December 31, 1931.

was amended on July 11, 1936, to allow Austrians to purchase travel marks at the usual discount and to provide for an increased exportation of Austrian dairy products. On January 27, 1937, another agreement sought to expand the mutual trade of the two countries by 40,000,000 Schillings through switching some of Austria's coal importations from Poland to Germany, which would then absorb an increased quantity of Austrian cattle, horses, dairy products, lumber, iron and steel, and such invisibles as travel and copyrights. Supplanting unilateral action on quotas, prohibitions, etc., a system of mutual agreement through permanent trade committees was inaugurated. With the introduction of exchange control in Poland, Austria put into effect the clearing arrangement of June 12, 1936, which was subsequently modified to permit increased "compensation" dealings.

Through the last years of independent Austria, clearing and compensation persisted as defensive weapons in international payments involving nine countries with strict controls themselves.¹

1. With three countries, Bulgaria, Greece, and Turkey, Austria maintained clearings chiefly for tobacco purchases, and with Rumania, Jugoslavia, and Czechoslovakia, trade proceeded largely by means of compensation. The Hungarian clearing, the only one to have been carried over from the earlier clearings on a gold par basis because it seemed to work reasonably well, had to be revised. Until mid 1934 no particularly large clearing balances were accumulated either way, since Hungarian wheat exports were paid for chiefly in devisen. In May of that year, however, the relation of Hungarian to Austrian wholesale prices suddenly increased from 64 per cent to 72 per cent, and thence forward with occasional small reversals it advanced to 100 in December, 1935. The tendency for Austrian exports to increase while Hungarian exports decreased was given a new impulse, and the adverse balance of Hungary in the clearings mounted to 15,000,000 Schillings and 16,000,000 Schillings in October and November, 1935. On November 27 the situation was at least partly remedied by an alteration of the clearing basis to provide a 10 per cent premium on Hungarian exports and a 13 per cent premium on Austrian exports to Hungary, approximating the purchasing power parity of 100 Schillings equals 90 Pengo revealed by Fig. 12, page 104, in the relative movements of wholesale prices and cost of living in the two countries. Austrian exporters, of course, opposed the measure strenuously. The year 1936 saw a decline of 17 per cent in Austrian export values to Hungary, despite an 11 per cent increase in export quantities, whereas import values increased by 28 per cent and import quantities by 79 per cent, the "balance" so essential to bilateral clearing was nearer realization, though substantial credits remained for Austria.

The clearing with Italy functioned smoothly until the Abyssinian War, which advanced prices and reduced Austrian purchases of citrus fruits, rice, and textiles, on December 17, 1935, the new clearing provided for the liquidation of Italian debts out of her exports to Austria. After the Italian devaluation another agreement, signed on November 7, 1936, compensated Austrian exporters for the new relation. During this year, also, the Rumanian clearing under-

Austria was never able, however, to escape the chronic malady of uncleared balances. During the period of gold-par clearing, as we have seen, the balance was continually adverse to Austria, amounting to 100,000,000 Schillings at its maximum. After the recognition of *de facto* devaluation, balances accumulated in the other direction through the adherence to artificial exchange rates by clearing partners. The difficulty was aggravated by increased purchase of Austrian raw materials by Danubian states in their efforts to find usable equivalents for exports under the clearings. Raw material prices were so severely advanced in Austria as to force her to a series of export-prohibitions in October, 1934, including cotton, non-ferrous metals, pelts and rags, and later such agricultural raw materials as hay and straw.¹ But, as we have seen from specific cases of clearing, the defensive measures did not avail. During 1936 and 1937 the existence of Austrian credit balances represented an equal abstraction of capital from her own economy, the National Bank could not, because of the risks, make advances upon all of these exporters' claims, and consequently there was bitter complaint against the handicap to recovery arising from these forced foreign loans.²

AUSTRIAN EXPERIENCE WITH EXCHANGE CONTROL TO MARCH 1938 IN RETROSPECT

The dramatic quality of the Austrian experience arises rather from the intricate but finally successful process of abandoning exchange control, except for an irreducible minimum, rather than from striking evidence of its economic accompaniments. The tardy introduction of control, the multifarious evasions, and the relatively short duration in anything approaching complete monopoly prevented any very marked effects upon domestic production. Complaints, for example, of a shortage of industrial raw materials for re-export in fabricated form were loud in the last months of 1931. went a revision (on May 15) which abolished the prevailing undervaluation of the *lira* relatively to the Schilling by leaving exchange rates to the free agreement of trading parties. A one sided balance of 14,000,000 Schillings in Austria's favor in the Czech clearing prompted a new arrangement on April 2 and May 15, 1936, by mid summer, the balance had nevertheless risen to 23,750,000 Schillings, and the Czech devaluation in the autumn did not prevent the persistence of uncleared balances.

1 O If K, Jhrg 10, Nr 11, p 280

2 Ibid, Jhrg 11, Nr 12, p 258, and Jhrg 12, Nr 2, p 24

and early 1932. Bankruptcies during the first three months of 1932 exceeded a weekly average of 100, the apex of a curve beginning in 1929 and extending to the present. The Berndorfer Metallfabrik, doubtless without full justification, ascribed its failure in June, 1932, directly to exchange control. Exchange control contributed to the embarrassment of many firms, but the shrinkage of domestic production is too closely allied to the general course of depression to admit specific measurement of this particular influence. The general impression prevails that agriculture

AGRICULTURAL PRICES*
(LOG SCALE, 1923-31=100)

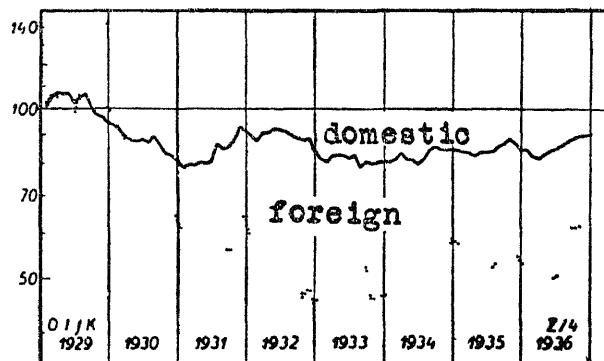


FIG 5

INDUSTRIAL PRICES*
(LOG SCALE, 1923-31=100)

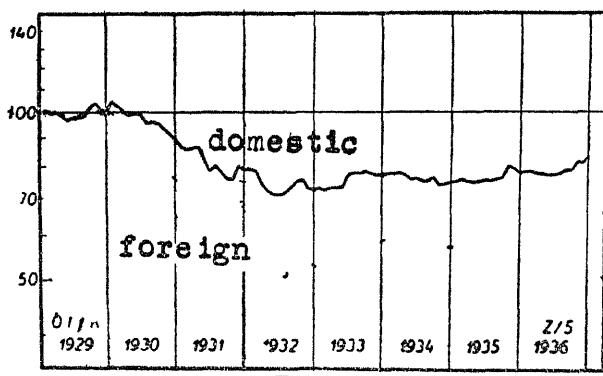


FIG 6

* O I f K , Jhrg 11, Nr 1, p 5, for both figures. For statistics, cf pp 356-358, below.

fared better than industry in the National Bank's allocation of devisen, but no records exist by which this can be definitely proven. Furthermore, the artificially high Schilling rate bore more heavily upon industrial production, since Austria exported preponderately in this category, and it afforded corresponding protection to agriculture. Figs. 5 and 6 reveal a wholly artificial recovery of domestic agricultural prices precisely through the period of most extensive exchange control (latter part of 1931 through 1932), when industrial prices both at home and abroad continued to sag and foreign agricultural products continued their downward course in price.

INDEX OF PRODUCTION, EXPORTS AND IMPORTS BY VALUE,
EXCESS OF IMPORTS (INDEX BASE 1929=100)*

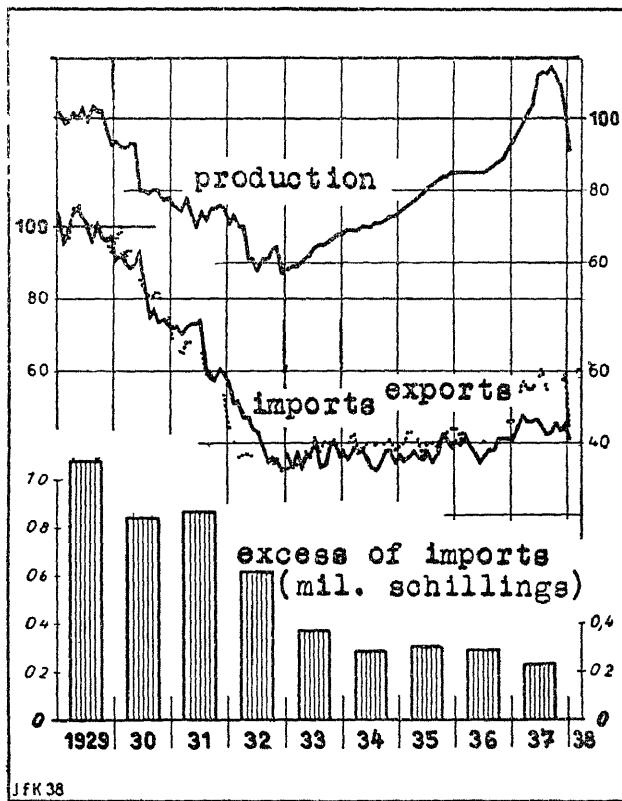


FIG 7

* O I f. K., Jhrg. 12, Nr. 3, p. 78. For statistics, cf. pp. 352, 359, below.

Extensive import prohibitions upon agriculture, put into effect in June, 1932, offset the weakening of agricultural protection through the departures from Schilling parity on the "private clearing" market

In the Austrian foreign trade, the effects of exchange control are again mingled with general causes, and Fig 7 reveals the marked reduction in the total volume of foreign trade even before exchange control had been introduced. But the abruptly descending segment of the import and export curves from mid-1931 to the end of 1932, while it undoubtedly reflects the composite operation of depression and all spontaneous and artificial factors militating against international trade, does coincide approximately with the period of "attempted monopoly" in Austrian exchange control. The continuance of both export indices for four years thereafter (1933 through 1936) at a low level of 40 per cent of 1929 values,¹ despite the dramatic improvement of production, rests on the prevalence in world trade of clearings, export and import quotas, import prohibitions, high protective tariffs and exchange control and, more specifically for Austria, the lack of commercial treaties with Hungary and Czechoslovakia. During this quadrennum, however, world trade proceeded at levels even slightly lower—35 per cent, 34 per cent, 35 per cent and 37 per cent of 1929 values. Thus Austria was able, by virtue of the abandonment of the official Schilling parity and the rationing of devisen, to escape with a penalty upon its foreign trade slightly less than that imposed by more autarkic countries.

Because of the short duration of exchange control in the narrow sense and the employment of market exchange rates in most of the important clearings after 1932, it is difficult to discover striking dislocations in Austrian trade with *particular countries* due to exchange control in isolation. The most conspicuous changes assume a nearly secular character antedating exchange control, and are for the most part ascribable to efforts of Austria and her chief trading partners at self-sufficiency.² But the situation is

1 The indices in Fig 7 show movements of exports and imports by values, but investigations by the Austrian Institute for Cycle Research reveal that the indices also are reliable for changes in volume. Cf ÖfK, Jhrg 12, Nr 2, p 52.

2 On the side of imports, Czechoslovakia declined steadily from first importance in 1922 with 23.6 per cent of the total to 11 per cent in 1937 through the loss of the Austrian market for wheat, fuel, textiles, and sugar,

otherwise if, instead of regarding each country separately, we group together all the clearing countries to contrast with countries having free payments in such an arrangement the aggregating of changes, each small in itself, in trade with particular countries ascribable to the presence or absence of clearing reveals a striking metamorphosis. Studies made by the Austrian Institute for Cycle Research, beginning with 1935 after the virtual abandonment of exchange control, except for the clearings, and hence revealing this factor in a fair degree of isolation, give the following results.

PERCENTUAL SHARE OF CLEARING COUNTRIES
IN AUSTRIAN TRADE

(January-September Values)*

		1935†		1936		1937	
		Imports	Exports	Imports	Exports	Imports	Exports
Clearing Countries	Volume	63.9	77.3	85.9	79.2	81.1	77.4
	Value	53.3	57.7	58.4	62.6	54.3	57.7
All Other Countries	Volume	36.1	22.7	14.1	20.8	18.6	22.6
	Value	46.7	42.3	41.6	37.4	45.7	42.3

* ÖfK Jhrg 11 Nr 11 p 240 cf also *ibid* Jhrg 11 Nr 9 pp 191-192 and Jhrg 12, Nr 2 pp 51-60

† Poland is omitted in 1935 figures not having yet adopted exchange control

Disregarding the absence of Poland in the 1935 figures for clearing countries, their share of Austrian imports rose by volume from 63.9 per cent to 81.1 per cent and by value from 53.3 per cent to 54.3 per cent over the years 1935-37, whereas the share of non-clearing countries fell by volume from 36.4 per cent to 18.6 per cent and by value from 46.7 per cent to 45.7 per cent. Because of the fixity of prices in clearing countries and the substantial rise of prices on free markets, the value figures belie the actual sharp deflection of imports to clearing countries.¹ On the side of exports

Since 1927 Germany has been the chief source of imports, accounting for 21 per cent in 1930 and 16.3 per cent in 1937. Hungary has held third place in importance, varying but slightly from a norm around 10 per cent (e.g. 9 per cent in 1937), and Italy at fourth place has accounted for 4-5 per cent of total imports. On the side of exports, these four countries have accounted for roughly half the total, with Germany again leading. Its importance, however, declined slowly through the period 1930-1937 from 17 per cent to 14.9 per cent, though the beginning of the decline dates back to 1928. Czechoslovakia lost ground from 1930 to 1937 from 12.8 per cent to 7.1 per cent, whereas Hungary and Italy both gained, the former rising from 7 per cent to 9.1 per cent and the latter from 10 per cent to 14 per cent. The fairly satisfactory working of the clearing supported Austrian exports to Hungary, and the Rome Agreements increased exports to Hungary.

¹ Ibid Jhrg 11, Nr 11, p 240

there was no net change over the years 1935-37, 77 per cent by volume and 58 per cent by value going to clearing countries and 23 per cent by volume and 42 per cent by value going to other countries. Comparison of export and import figures indicates the probability that it was an effort — for the most part not successful — to draw upon credit clearing-balances which accounts for the deflection of imports to clearing countries.

Beside its influence upon international trade, exchange control affects the foreign value of currencies. One would expect that

THE PRICE OF GOLD IN AUSTRIA*
(AS PER CENT OF PARITY)

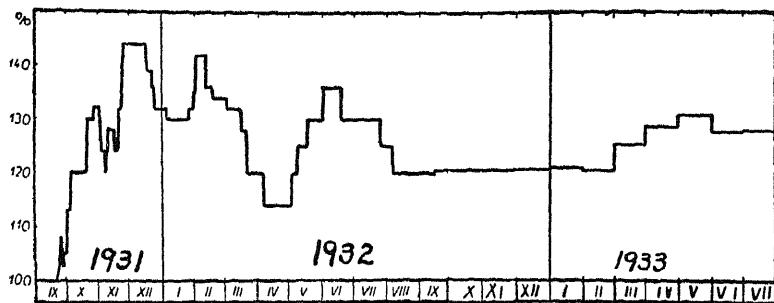


FIG. 8

* O I f K , J h r g 6, Nr 9, p 132. The figure has been extended through July 1933. For statistics, cf p 360, below.

exchange control would reveal itself in short-run variations in the value of the Schilling, but that the basic factors would prove to be such determinants of purchasing power parity as the relative movements of domestic production and money. These expectations appear to be fulfilled. The course of the price of gold in Vienna¹ shows short irregularities which will presently be explained in terms of control measures, but the eventual level of 128 per cent of par, reached by July, 1933 (cf. Fig. 8, above), is almost the exact reciprocal of the movement of the index of production from 79 in April, 1931, just before the Credit Anstalt failure, to 65 in July, 1933 (cf. Fig. 7, p. 61), with the total of central-bank sight liabilities and notes remaining at approximately the same amount.

1 By a strange anomaly the publication of the price of gold at the Mint was never forbidden, even during the months of most rigorous attempts at maintaining official parity.

(1,100,000,000 Schillings) at both dates (cf Fig 1, p 31) Other comparisons yield similar results Gold premia during the latter part of 1931 and 1932 fairly closely reflect the lag of Austrian prices downward in comparison with Germany (cf Fig 9, below) and the United States (cf Fig 3, p 34 and Fig 10, p 66) In Fig 10 the movements of Zurich quotations on Schillings (reversed to show what Swiss franc quotations would have been in Vienna had they been permitted) and the Vienna quotations on a favorite Swiss bond describe courses resembling the variations of the gold price

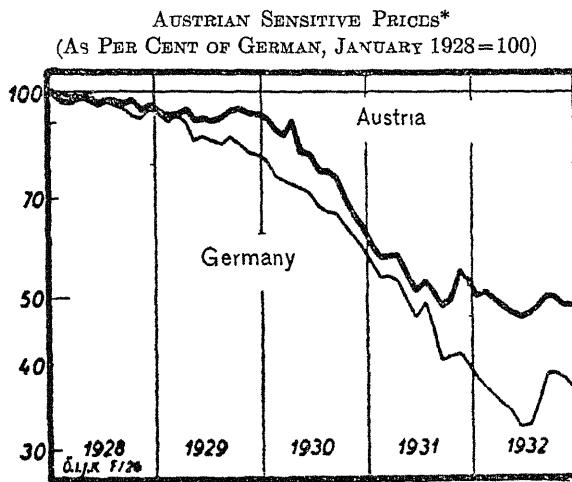


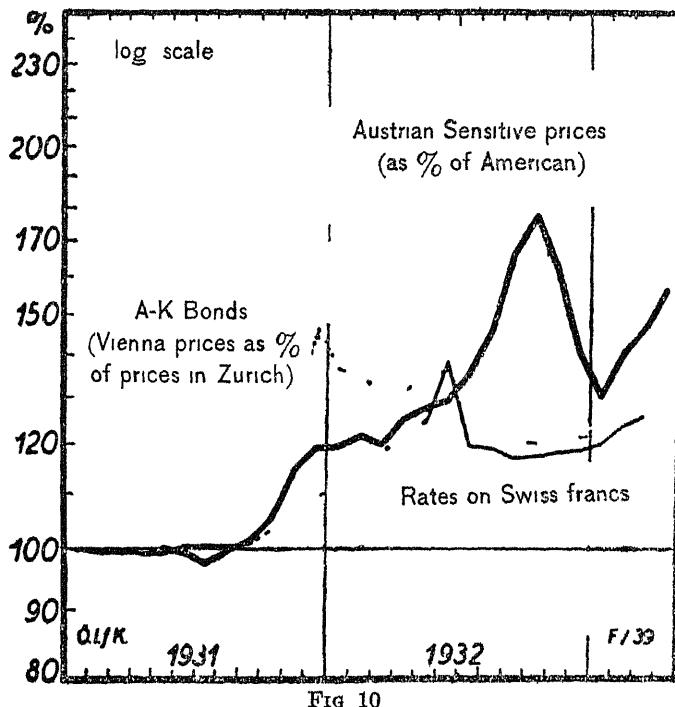
FIG. 9

* O I f K , J h r g 7 , N r 2 , p 23 For statistics, cf pp 353-355, below

Shorter variations in the value of the Schilling are associated with certain phases of exchange control The late November and early December, 1931, peak in the price of gold (142 per cent of par) and of A-K Bonds seems to have been caused by the pressure of capital flight carrying foreign devisen and *valuta* values beyond purchasing power parity The evasion device of "export against Schillings," thriving between the Third and Fourth Devisen Laws, permitted an effective capital flight without resort to devisen or *valuta* When this practice was stopped by the Fourth Devisen Law, and it was also made illegal to accept payment for exports in foreign securities, the A-K Bonds declined, but gold prices rose, through January The accession of Dr Kienbock and the begin-

nings of private clearing in February, 1932, gave the exchange market reassurances and permitted a fall of foreign exchange and security values toward their eventual equilibrium level. But this was also the time when the early gold-par clearing gave relief to importers and removed their pressure on devisen, a change reflected

INDICES OF THE DEPRECIATION OF THE SCHILLING*



* Ö If K, Jhrg 7, Nr 4, p 64. For statistics, cf pp 353-355, below.

in the marked fall of gold prices to 117 per cent of parity. The termination of Italian, Jugoslavian, and Swiss clearing in March, and the subsequent necessity for liquidating unpaid Austrian balances swung the pendulum in the other direction by the end of the next month. During May both the prices of gold and A-K Bonds reached a point above their final levels at a time when maturities were particularly heavy and the Transfer Moratorium was imminent. Following its provisional introduction on June 27, relief given the balance of payments produced a sag in gold price,

A-K Bonds, and Swiss exchange curves until March, 1933. Thereafter the gradual resumption of transfer raised the curves somewhat, until finally a position of apparent equilibrium was realized by the eventual gold premium of 28 per cent.

Conceding, as do some of the most intransigent foes of exchange control, that interferences with exchange rates and transactions in October, 1931, could scarcely have been avoided, what is to be said of the actual course of events in 1932? All official organizations representing industry, commerce, and trade¹ came sooner or later to demand in categoric terms the removal of exchange control, and they were seconded by economists connected with the Austrian Institute for Cycle Research.² The Chamber of Commerce actually recommended³ deflation sufficient to restore the parity of the Schilling, but by mid-summer of 1932 the *de facto* depreciation was generally accepted as the appropriate basis for returning to free payments.⁴

Admitting the desirability of clearing away the hampering, ineffective and costly⁵ apparatus existing at the end of 1931, one must sympathize with the cautious course pursued by the National Bank. At that time the great obstacles to immediate and complete abolition of control were four: the foreign and domestic debts, the dubious state of public psychology regarding the standard, and the question of securing payment for exports to exchange-control countries. Both the Biuniis agreement and the Bank for International Settlements-Bank of England credits were being renewed.

1 Including the Genossenschaftsverbände des Gewerbes und der Kaufmannschaft, the Hauptverband der Industrie, the Handelskammer, and the Vienna Borsekammer.

2 E.g. Oskar Morgenstern, Neues Wiener Tagblatt, February 3 and September 10, 1932; Fritz Machlup, ibid., November 11, 1932; Gottfried Haberler, ibid., August 14, 1932.

3 Cf. Wiener Kammer für Handel, Industrie, und Gewerbe, Geschäftsbericht über den Monat März, 1932, pp. 47-49.

4 E.g., Neues Wiener Tagblatt, September 20, 1932, Arbeiter Zeitung, October 11, 1932.

5 The following is an estimate of costs of its own exchange control department during the first four years put at my disposal by the Austrian National Bank.

	Employees	Supplies	Total
1931, October 9 to December 31	\$527,000	\$141,000	\$668,000
1932	1,328,000	103,000	1,431,000
1933	535,000	46,000	581,000
1934	240,000	27,000	273,000
1935 half year	134,000	5,000	139,000

for six-months intervals only, the Credit Anstalt Agreement was still far from a satisfactory formulation, and the devisen reserves of the National Bank were being depleted by the remaining debt service. Furthermore, no one could advance a ready solution to the middle of domestic debts expressed in foreign currencies, the process required time not only for a crystallizing of opinion and elaborating of details, but also for bringing recalcitrants to the realization that compromise would be necessary. Again, although it was stated by the proponents of immediate removal that 90 per cent of the population already recognized the *de facto* Schilling devaluation, this "population" must be restricted to bankers, brokers, leading merchants, exporters and importers. The man on the street scarcely realized the fact even ultimately, since devaluation was never made public, its recognition in 1932 might easily have loosed a disastrous velocity inflation and a renewal of the capital flight. Even under conditions prevailing prior to March, 1938, after the foreign debts had been completely funded, the principal reduced, and the service of the debt lessened by conversions, and after the problem of the domestic foreign currency debts had largely been solved, a modicum of control persisted. The stability of the Schilling despite gold-bloc devaluations had virtually removed any threat of panic psychology. But, as President Kienbock pointed out,¹ two circumstances required the retention of formal control. Clearing agreements are generally terminable on short notice by either country, without exchange control the Austrian Bank would have been left without authority to impose a defensive freezing of foreign balances to force settlement of its own claims. The action of both England and Italy in empowering the central bank to introduce "compulsory clearing" in emergency is a parallel to the power retained in Austria under the Devisen Acts by the National Bank. In the second place, so long as contiguous countries exercised exchange control, it was necessary for Austria to control payments in order to avoid abuse of the transit trade, since otherwise third countries could have paid merely in clearing balances while the Austrian transit firm would have had to pay the original exporter in devisen.

¹ Mitteilungen, loc. cit., pp. 329, 331

THE INCORPORATION OF AUSTRIA INTO THE GERMAN EXCHANGE CONTROL SYSTEM

In the cases of the Saar in March, 1935, and Sudetenland in October, 1938, the existing German exchange control laws were applied in their entirety by one decree. Because of the greater magnitude of the undertaking, the complexity of problems, and a necessary considering of political possibilities, the German authorities proceeded in the case of Austria very circumspectly, at first retaining the "devisen frontier" between the two countries completely, and then only by a series of tentative steps arriving at the assimilation through a general recodification of devisen laws on December 12, 1938, exactly nine months after the political change.

Inasmuch as prices in Austria before annexation lay considerably lower than the German level at the old clearing ratio of two Schillings to the Reichsmark, it was necessary to choose between a rise of Austrian prices, if the old relation were retained, or a simple recognition of the higher real value of the Schilling, if price stability were preferred. The first alternative was at first officially adopted, but the German Chancellor on March 17 decreed the official Schilling-Mark ratio to be S3=Rm2, choosing thereby to avoid the politically unpalatable upward adjustment in Austrian prices. At the time of its introduction the 3:2 relation seems to have approximated the Austrian-German purchasing-power parity based on costs of living, so far as this may be computed despite differences in kind and quality of consumers goods and services. Substituting the 3:2 rate for the old 2:1 clearing rate made German exports to Austria cheaper by 25 per cent and Austrian exports to Germany dearer by 33 1/3 per cent, and approximately removed artificial distortion of trade between the two countries. If a computation is made over the *official* value of the mark,¹ imports from other countries than Germany became cheaper by 30 6 per cent and exports dearer by 44 per cent, the divergence between the second pair of percentages and the first being explained by the fact that the 2:1 Austrian-German clearing rate had already recognized a small percentage of depreciation in the Mark. If a computation of the change in the effective rate of exchange for Austria were carried out over the Mark rates actually prevailing in German clearings and sales of blocked Marks, considerably lower per-

1 As was done in [Ö] IfK, Jhg. 12, Nr. 7, p. 178

centages would be given than 30.6 per cent and 44 per cent, but since the items as well as the source and destination of trade would be quite different for Austria before and after annexation, the results would be rather fanciful. Aside from this unreality these percentages indicate the artificiality of the official Mark value as imposed upon the Austrian economy with reference to non-German trade.

On the second day after the proclamation of German sovereignty, payments abroad in domestic or foreign bills of exchange were forbidden to private parties, as was also the export or import of Austrian and German currency. To cope further with the immense pressure of flight capital, the authorities limited withdrawals from demand and saving accounts to 1,000 Schillings weekly, and the gamut of precautionary measures was subsequently run through — limitation of money for foreign travel to the equivalent of 50 Schillings, compulsory sale of precious metals, foreign securities, Devisen, and money to the Reichsbank, blocking of emigrants' bank accounts, etc. Curiously enough, the channel of evasion through "export against Schillings," which had flourished as a mode of transferring flight capital under Austrian exchange control in late 1931 (Cf. p. 40), enjoyed a brief resurrection until the practice was stopped by the German Devisen Office in Vienna by decree of May 21.¹ The Second Devisen Law of June 1 applied to Austria the system of "Number Control" utilized in Germany to cope with capital flight effected by smuggling out domestic money, purchasing German securities abroad, and secretly bringing the securities back into Germany (repatriation).

Imposition of the German Standstill and Moratorium decrees upon Austria followed as a matter of course. Formally the step was not taken for short-term foreign debts until November, 1938, possibly because the sum owed by Austrian banks and industries did not exceed 47,000,000 Schillings. The long and medium term debts of 1,834,400,000 Schillings in 1937 came under the Moratorium law of 1933 by a decree of April 29, requiring Austrian debtors to pay into the German Conversion Office and offering to creditors the choice of blocked accounts or the regranting of loans at reduced interest. As for the Austrian public debts, Germany declined on principle to recognize them, on the ground that they had been contracted to prevent the *Anschluss*. Nevertheless, after

¹ Devisenarchiv, June 7, 1938, pp. 547-548.

threats of compulsory clearings on the part of creditor nations and protracted negotiations, agreements were arrived at with England, Holland, Switzerland, and France, embracing 55 per cent of the creditor interests. English creditors fared best, with full servicing of the loans of 1933-53 and 1934-59 an interest reduction from 7 to 5 per cent upon the Federal Loan of 1930, and 50 per cent transfer upon the service of others. The Dutch secured nearly as good terms, but in the case of Switzerland and France existing transfer arrangements between Germany and these countries were simply applied without preferential treatment of Austrian loans.

The measure of creditors' success largely depended in these cases upon the size of the creditor country's adverse balance of trade with Germany. Since the United States had a favorable balance, it was unable to secure concessions, and fell therefore under a blanket offer made by Germany, still refusing any formal recognition of obligation to Austria's creditors, to convert the holdings to a Reich Loan at 4½ per cent with a 2 per cent sinking fund without transfer.

The proclamation of the new Schilling-Mark ratio immediately raised complicated issues as to the terms of settlement of outstanding commercial obligations. So far as concerned foreign debts or credits in terms of a foreign currency, it was immediately decided that until April 25 devisen would be bought and sold by the National Bank at the last quoted rate on Schillings on the old private-clearing market. By this arrangement Austrian exporters, of course, gained and importers lost in comparison with what would have been paid and demanded for devisen had the Reichsbank's rates been applied, but the decision was clearly not motivated by this consideration but rather by the desire to secure *holdings* of foreign devisen in Austrian hands. The arrangement prevailing until April 25 permitted the settlement of commercial debts in foreign currencies without loss to the creditor — either Austrian or foreign — in terms of foreign currency.

With regard to commercial debts in Schillings, however, the question of settlement threatened to bring certain sectors of foreign trade to an absolute *impasse*. Austrian importers refused to discharge their obligations at the higher sums in foreign currencies involved in the 3 2 ratio of Schillings to Marks, while foreign importers could not be induced to acquiesce in the upward valorization of their debts in terms of their own currencies. The *impasse*

was especially troublesome in the clearings, where Austria had a net creditor position of 134,000,000 Schillings A part of this total, the equivalent of 30,000,000 Reichsmarks owed by Germany, was immediately repaid at the old clearing rate 2 1 Not until June 5, however, was there established any norm for the balance On that date the Vienna Devisen Office declared that the S3=Rm 2 ratio had been intended merely for domestic relations, that obligations in Schillings entered into before March 17 were not thereby affected, and that, aside from special arrangements, settlement would be made on the basis of the last private-clearing quotation on Schillings This decision put the Austrian exporter who had sold for Schillings in a position exactly the reverse of that which would have resulted had the sale been made in terms of foreign currency in the present case he received the equivalent of only 70 Schillings in payment of an invoice for 100 Schillings The same inequities appeared in the settlement of Austria's unfavorable clearing balances

The process of incorporating Austria into the German trade system would have been rendered still more difficult by the automatic increase in all protective tariffs entailed by raising the Schilling to the overvaluation attaching to Mark currency By decree of June 23, the customs duties, which by a quaint anachronism had been stated in terms of the old Austrian gold crown, were henceforth reduced to their pre-March level by computing the crown at a rate of 90 Reichsmarks instead of 1 22

In the economic relations of the Altreich with the new Ostmark, the German authorities introduced many precautionary measures against a cataclysmic alteration of production and price conditions, particularly in the old Austrian territory Although German tariffs upon Austrian goods were removed almost immediately — on March 26 — Austrian tariffs upon German goods were at first maintained However, every import into Germany required in advance a permit from the German Import Control Office (*Überwachungsstelle*), ostensibly "to prevent denuding Austria of raw materials" A law preventing acquisition by citizens of the Altreich of new or old businesses or securities belonging to citizens of the Ostmark was maintained with gradual relaxation even after June 1, when the "devisen frontier" between these regions was abolished Gradually the Austrian tariffs on German goods were reduced by measures introduced on April 7, 23, 26 and on July 1,

and their complete removal followed on October 1. Even then for several months exporters and importers in both parts of Germany under certain officially inspired "territorial protection agreements" were prevented from invading previously existing market territories.

The imposition of "price-stops," beginning with a decree of March 18, has apparently a permanent character, their presence interferes with the effort to trace economic consequences of the *Anschluss*. The number of unemployed was reduced, according to German statistics, from 403,643 in April to 112,745 in November, 1938. Nearly all significant indices, including the index of production, have not been carried forward, and it is impossible to isolate in the available trade statistics the share of German foreign trade carried on by the former Austrian territory. Until August, 1938, statistics of car-loadings for imports and exports exclusive of the Altreich were available and revealed an 18 per cent shrinkage in imports and a 33 per cent shrinkage in exports in the five months April-August, 1938, compared with the previous year, despite a revival of world trade.¹ Complaints have been heard concerning the decline of the Ostmark textile and paper industries and the Vienna luxury goods exports. Although the loss of foreign trade as measured in car-loadings is more than offset for both exports and imports by increases in trade with the Altreich, the decline of Austrian *foreign* trade is in many respects more significant for Germany as a whole, especially in the light of its 433,000,000 Reichsmark adverse balance in 1938.

¹ Ö If K, Jhrg 12, Nr 8, pp 200-201

CHAPTER III

HUNGARY'S STRUGGLE WITH AGRICULTURAL DEPRESSION AND INDEBTEDNESS

ECONOMIC AND FINANCIAL CONDITIONS OF 1931

The disaster which overtook Hungary in the summer of 1931 had its roots in four adverse developments, in addition to the background of world depression, in the years preceding (1) the excessive capital imports of the period 1924–1930, and (2) the defects of the banking system, but more immediately (3) the movement toward agricultural autarky in Europe, and (4) the general decline of agricultural prices

Between 1924 and 1930 Hungary borrowed 2,026,000,000 pengo,¹ one-fourth of which was at short term.² Of this tremendous sum, 50 per cent went into federal and communal investments, made without much reference to productivity in a technical sense, and 40 per cent went to agriculture, where a large proportion was absorbed simply in the division of property rights.³ Agricultural property accumulated mortgages to 37 per cent of its value.⁴ The country had become oriented to a continuous capital influx, a "prosperity fever" infected borrowers and lenders as well, especially the American. But a reflux of securities began in 1929 capital import sufficed only for the debt service, and during 1930 capital was withdrawn from Hungary on balance, reducing the reserves of the National Bank by 100,000,000 pengo, or one-third. At the time of the credit crisis in 1931, total foreign indebtedness amounted to 4,310,000,000 pengo, with not more than 2,470,000,000 pengo at long term.⁵ The per capita foreign and domestic indebtedness of 613 pengo in 1931 was the largest in Europe, half again as large as Germany's or Austria's. Even for the years 1926–1929 the aver-

1 Office Central Royal Hongrois de Statistique, *Donnees de Statistique Economique*, 1928–32 (Budapest, 1933), p. 9.

2 Dr Anton Éber, *Ungarisches Wirtschafts-Jahrbuch*, Vol. 8 (Budapest, 1932), p. 322. This yearbook hereafter abbreviated as *Ung. Wirt. Jhrb.*

3 Georg Kemény, *Österreichischer Volkswirt*, September 5, 1931, p. 1286.

4 Idem, *Pester Lloyd*, January 6, 1933, p. 11.

5 Magyar Statisztikai Szemle, Vol. 10, No. 8 (Budapest, August 1932), p. 677.

age per capita income was only 514 pengo per annum, according to Professor Fellner's calculations, and by 1931 it had sunk to 360 pengo¹

"The situation of the banks was satisfactory" a representative of the leading Budapest banking organization reported on May 15, 1931² Within a few weeks, however, the banks were found to be in a highly illiquid condition, and only extensive government aid prevented wholesale insolvencies As the League of Nations enquiry points out,³ the peculiarly intimate association of banks with industry in Hungary, and the merging of all types of banking business in the same institution, including commercial and mortgage operations, rendered the whole credit structure particularly vulnerable to weakness in any one quarter, for example, in agriculture Within a six-year period from 1925 discounted bills increased from 651,000,000 to 2,010,000,000 pengo, mortgage loans from practically nothing to 668,000,000 pengo, while the foreign short-term obligations mounted to 823,000,000 pengo

Meanwhile in continental Europe there was developing in the chief markets for Hungarian grain an approach to self-sufficiency which would eventually have brought the country to grief, even without a world economic depression France succeeded by protectionist measures in raising the yield per hectare of her wheat lands from 13.9 quintals in 1924 to 17.1 quintals in 1933, Germany, during the same span, from 16.6 to 24.2 quintals⁴ German wheat imports declined from 14,448,000 to a mere 3,000 quintals over these nine years⁵ The consequence of European agricultural autarky, conjoined with competition of American grains produced under revolutionary cost reductions, was a catastrophic reversal for Hungary Both in value and volume her exports had increased far more than any other country's in the last two prosperity years, 1927 to 1929⁶ But even at the average prices obtained for farm products from 1925 to 1927, the value of Hungarian agricultural

1 League of Nations, Quarterly Reports on the Financial Condition of Hungary (hereafter by the author's name) Royall Tyler, First Quarterly Report (January 12, 1932), p 10

2 The Stock Exchange Gazette (London), Vol 31, p 1139

3 League of Nations, Commercial Banks (Geneva, 1934), p 133

4 P N Panaitescu, *Les contingements dans les relations commerciales avec les pays agricoles* (Paris, 1935), p 9

5 Ibid, p 25

6 Actually by 140 per cent Cf League of Nations, Course and Phases of the World Economic Depression (Geneva, 1931), p 126

exports declined from 936,700,000 pengo in 1929 to 920,500,000 pengo in 1930, and to 680,400,000 pengo in 1931

In addition there was the precipitous fall in world prices, especially for agriculture, which notoriously reacts to a decline of values by maintaining production. World agricultural production on a 1925-1929 base stood at 104 in 1929, 103 in 1930 and 1931, and 102 in 1932, whereas the indices of industrial production were 114 in 1929, 101 in 1930, 86 in 1931, and 73 in 1932.¹ Inexorably the "agricultural price shears" reduced the ratio of agricultural prices to non-agricultural wholesale prices from 103.7 per cent in December, 1929, to 82 per cent in December, 1930, and 65.4 per cent in December, 1931.² The collapse of agricultural values, operating together with the decrease in physical volume of exports to autochthonous countries, produced a decline in Hungarian agricultural exports, taken at their actual values, from 887,700,000 pengo in 1929 to 745,700,000 pengo in 1930 and 431,600,000 pengo in 1931, or to less than half in two years.³ The accentuation of this tendency through 1932 and its persistence through 1934 help to explain the continuance of exchange control in Hungary.

THE INTRODUCTION OF EXCHANGE CONTROL, MORATORIA, AND STANDSTILLS

The advent of exchange control is marked by three periods, the first extending from the failure of the Credit Anstalt to the bank holidays in July, 1931, the second to the middle of August, and the third to the moratorium at the end of the year.⁴ When the balance sheet of the Credit Anstalt appeared on May 8, a run was begun upon the Hungarian General Credit Bank, holding nearly a third of Hungary's 823,000,000 pengo short-term banking obligations to foreigners. Withdrawals shortly mounted to 45 per cent of the bank's liabilities. Possibly the situation was less acute than in Austria, since the General Credit Bank embraced not more than 20 per cent of the liabilities of the ten leading banks of Budapest. Even so, the Hungarian National Bank advanced its rediscount rate on June 15 from 5½ to 7 per cent and began negotiation with

1 Z. Koós, Central European Agriculture and the Problems of Foreign Debts (Budapest, 1934), p. 5

2 Ungarisches Institut für Wirtschaftsforschung, Vol. 25, p. 56. Hereafter referred to as U.I.f.W.Cf.Fig. 15, p. 99

3 Ibid., p. 40

4 Richard Quandt in Ung. Wirt. Jhrb., Vol. 8, pp. 283-294

foreign banks for the floating of an Emergency Loan to the Treasury. Free exchange and payments were maintained, despite a shrinkage of gold and devisen reserves from 47.9 to 39.4 per cent over the two months, as portayed in Fig 11, p. 91.

On July 13 came the failure of the "Danat" Bank and the declaration of bank holidays in Germany. Hungary followed suit, closing the banks until the 17th and the Stock Exchange indefinitely.¹ The first decree monopolizing the foreign exchange market and forbidding outward payments without permission of the National Bank was published on July 17. The weeks immediately following witnessed a fever heat of panic. Note circulation from the middle of July to August 7 expanded by 159,000,000 pengo to a peak for the year of 504,000,000 pengo and central bank support of institutions suffering withdrawal necessitated an expansion of its bill portfolio from 244,000,000 pengo on May 7 to 608,000,000 pengo on August 7.²

Events in mid-August, however, combined to relieve the crisis. Arrangements for an Emergency Loan, which had been going forward since the run on the General Credit Bank, came to fruition on August 14 in the formal "Paris Agreement." Through the intermediation of the Bank for International Settlements and various central banks, the Hungarian Government placed 139,000,000 pengo in Treasury Certificates on European markets, participations being 40 per cent by the French, 10 per cent each by the Swiss and Dutch, and 30 per cent by the large Hungarian banks themselves. This credit was subsequently extended at three-months intervals until its consolidation for three years in 1933.³

August 14 also saw the passage of Hungary's famous Gold Pengo Law, declaring all old debts (including bank deposits), past and future obligations to the state, and all future contracts in gold to be gold pengo debts.⁴ A supplementary decree provided that,

1. The Stock Exchange did not resume full activities until September, 1932.

2. For central bank credit and bills discounted, cf. Fig 11, p. 91.

3. On October 18 1933, the National Bank of Hungary agreed with the Bank for International Settlement and the central banks to pay one per cent interest and two per cent annual amortization on 119,000,000 pengo, the original loan after deducting 20,000,000 pengo for a special amortization from gold reserves. For the effect of this agreement on the Bank's balance, see Fig 11, p. 91 and p. 361 below.

4. The Gold Pengo Law was not altogether without precedent in Hungary, for during the post-war inflation a "Savings Crown" had been introduced for debts — a sort of tabular standard aiming at stability of obligations in terms of real values.

until the end of August, the paper pengo was to be regarded as a gold pengo, and that thereafter the National Bank was to establish daily a ratio between the two. But on August 29 the Bank was relieved of this duty, and the ratio, quite naturally, has never been published, since this would be tantamount to a devaluation of the pengo while all debts remained payable in gold. The obligation of banks, particularly, to pay in gold pengo has since proved an incubus, but the bizarre legislation had immediately a beneficent effect to secure the privilege of effective revalorization in case of currency devaluation the banks converted their cash holdings to balances with the central banks, and private persons, by the same token, redeposited their hoarded currency in the banks. Rumors on September 23 that the Bank would publish a gold-paper ratio even produced the curious phenomenon of a run *into* the banks.¹ Doubtless the Gold Pengo Law was originally enacted in good faith. When a gold premium of one or two per cent appeared on the black market, the Bank could see no gain in alarming the public by an official acknowledgment of depreciation, and when the premia advanced to much larger percentages, the Bank lacked courage to take the fateful step, though it continued to pretend that the Law was "the principal measure for protecting the currency."¹

Another measure in mid-August was the erection of the Hungarian Guarantee Bank with a capital of 50,000,000 pengo subscribed by the government, the large banks, and industrial concerns. Its function consisted in endorsing eligible paper in order to increase general liquidity. Although it did not begin operations for another year, its foundation helped to allay the panic.

The combined effect of the Emergency Loan, the Gold Pengo Law, and the establishment of the Guarantee Bank was such that on August 17 bank deposits, which had been subject to a maximum limit on withdrawals of five per cent for July and again for August, could be liberated for domestic use. The third phase of the early history of exchange control in Hungary was characterized by the disappearance of acute panic, a reduction in credit demands on the banks, and the elaboration of a control apparatus described in subsequent pages.² Nevertheless, the contraction of business and

1 National Bank of Hungary, Reports Submitted to the Eighth Ordinary Annual Meeting (Budapest, 1932), p. 12.

2 From its maximum of 608,000,000 pengo in August, the central bank's portfolio decreased to 520,000,000 pengo on October 23, and despite the usual

production was such that, even with a nine per cent rediscount rate, Hungarian prices rose by six per cent against a two per cent rise in gold bloc countries from August through December, 1931.¹

Under the embargo on foreign payments imposed by the Devisen Decree of July 17, the National Bank continued for several months to permit payments in private debt service. Hungarian commentators agree that an outright moratorium was impossible in the summer and early autumn of 1931, because of its probable psychological effects and because of the necessity of proving to foreign creditors that the debt service spelled financial ruin. By December ruin was actually imminent. Ten leading Budapest banks had experienced a 35 per cent loss of deposits, the central bank a reduction of reserves from 43 to 25 per cent. Had it not been for the 139,000,000 pengo Emergency Loan, reserves would have disappeared completely, since they amounted to only 118,000,000 pengo at the end of 1931. After deducting the necessary cover for the note circulation, only 3,000,000 pengo could be used for debt service, while maturities in late December and early January equalled 20,000,000 pengo.² There remained only the resort to Transfer Suspension or Moratorium, a step taken on December 22 by decree that for one year all payments owing abroad on bonds and debentures should be made into a Foreign Creditors' Fund with the National Bank, which should undertake the transfer to foreign countries in devisen.³ Embraced under the Moratorium were long-term debts estimated at 2,470,000,000 pengo with an annual service estimated at 287,000,000 pengo.⁴

As for the short-term debts, Hungary did not have the advantage of Austria in connection with the Credit-Anstalt of an early private agreement with her chief banking creditors. It was not until three months after the Moratorium that the First Standstill seasonal movement, did not exceed 589,000,000 pengo at the end of the year. Note circulation decreased from 504,000,000 pengo to 352,000,000 pengo from August 7 to September 23, and to 423,000,000 pengo at the end of the year, or 46,000,000 pengo less than the figure a year previous.

1 U I f W, Vol 24, p 124

2 Tyler, First Quarterly Report (January 12, 1932), p 9

3 Hungarian National Bank, Laws and Decrees concerning the Safeguarding of Normal Conditions of Economic and Credit Life (Budapest, 1932), pp 41-42. The League of Nations 1924 Reconstruction Loan was excepted from the Moratorium decree.

4 Cf respectively Pester Lloyd, January 6, 1933, p 13 and Economist, July 18, 1933, p 75 for these estimates by Dr Julius Walders and the League Financial Committee.

could be arranged Reference to the curve showing the portfolio of the National Bank (p 91) reveals the extensive aid given to commercial banks in these months, the sound appearance which their balance-sheets took on as a result probably delayed the Standstill Furthermore, the American representatives objected to the priority of the League Loan, and attached their signatures to the agreement made by the others on March 31, 1932, only after the Hungarian default on the League Loan in July The first Standstill, applied to debts outstanding on February 1, 1932, provided that there should be no discrimination amongst creditors, that interest should be paid by debtors into a blocked pengo account with the National Bank, and that no capital repayments should be made except by cancellation against Hungarian balances abroad Out of a total short-term indebtedness of 1,838,000,000 pengo, the Standstill included 823,000,000 pengo¹ We shall return later to the tortured history of the Moratorium and Standstill

THE HISTORY OF EXCHANGE CONTROL

Regarded from the angle of the terms upon which devisen were bought and sold by the Bank, the Hungarian experience reveals four major phases From mid-July, 1931, to the late months of 1932 a fairly literal application of official parity was attempted, any deviations assuming the aspect of evasions or specially authorized exceptions The turn of the year 1932-33 witnessed a widespread recognition of non-par rates in the form of an enormously complex array of differential premia, a condition prevailing to December, 1935 After the introduction at this date of the scheme of "linear" premia and surcharges, control of foreign exchanges in Hungary underwent substantial simplification and reduction, culminating in the summer of 1937 in the gradual removal of the Moratorium and the complete recasting of the Standstill The fourth phase, extending from mid-1937 to the present, involves a somewhat milder form of exchange control with effective transfer of the debt service in free exchange Each phase is complemented by foreign-payment arrangements, through clearings, compensations and the like, of distinctive character

The general system evolved in the first year resembled the early organization in Austria petitions from importers for devisen

¹ Magyar Statisztikai Szemle, loc cit

went first to certain designated banks, then to an intermediary advisory authority, and finally to the National Bank. The Union of Manufacturers, the Agricultural Institute, and the Budapest Chamber of Commerce functioned in various spheres in the intermediate capacity. A few large firms, under an arrangement resembling the Austrian "certificates," received "compensation licenses" permitting them to retain enough devisen to pay for imported raw materials used in exported goods, other firms were granted this privilege only *ad hoc* for certain transactions. Some exporting even at this early juncture was authorized as against frozen pingo, and also, by special dispensation of the central bank, a practice resembling the Austrian "private clearing" began to gain ground. Hungarian metal industries, for example, obtained devisen for imported raw materials at a 12 per cent premium from exporters of poultry, and cotton spinners derived devisen under similar terms from exporters of beans, seeds, poultry, and sheepskins. In October, 1932, President Eber of the Chamber of Commerce estimated these transactions for the preceding eleven months at 60,000,000 pingo.¹ But outside these officially recognized channels, apparently an even greater volume of trade had to avail itself of smuggled devisen at agios ranging from 23 to 30 per cent.² The initiation of formal piemia and surcharges at the turn of the year 1932-1933 recognized something already approaching a *fait accompli*.

During the period of control, when the official rate was actually applied, Hungary entered into gold-par clearings with Czechoslovakia, Switzerland, Austria, France, Germany, Italy, Belgium, and Rumania, in order given, between October 31, 1931, and October 8, 1932. With the exception of the Austrian clearing, which functioned reasonably well, because the Schilling and pingo were about equally depreciated, and because the Hungarian favorable balance was covered by Austria's payments for wheat in devisen, none of these clearings worked satisfactorily. The over-valued pingo in the relations with other countries piled up a total adverse clearing balance of 15,000,000 pingo at the half-year and 42,000,000 pingo at the close of 1932. Furthermore, since all commodities were admitted to clearing, the Hungarian authorities complained of a loss of control over imports, and the complemen-

1 Ung Wirt Jhrb., Vol 8, p 323

2 Österreichischer Volkswirt, Vol 27, p 227

tary device of direct barter or "compensation" occasionally resorted to, with its forced day-to-day balancing of visible exports and imports — and only visible items could be admitted — served rather to restrict than to promote trade, at least in comparison with clearing.

The inadequacy of devisen supplies for industrial raw materials at the Bank's official parity rate and the incubus which this rate imposed upon Hungarian agricultural exports began shortly to force an extension and regularizing of transactions at something approaching real equilibrium rates. On December 1, 1932, formally marking the beginning of the second phase of exchange control in Hungary, a "Compensation Bureau" was established to determine the premia to be allowed exporters for each commodity and country. The Ministry of Commerce administered the "Devisen Fund" which arose from exchange surrendered by exporters, and which was allocated to different import groups at various surcharge rates. To receive rations of devisen from this fund, importers had to sign a pledge not to raise domestic prices, despite the surcharges imposed upon them. In February, 1933, a "Foreign Trade Commission," representing the various Ministries and the Bank, and a "Foreign Trade Office" began their advisory functions, attempting to encourage exports to countries without exchange control. So far as can be determined from published information,¹ the average premia and surcharges for the first ten months (to September 30, 1933) were 13.4 and 16.9 per cent, by January, 1934, the averages to date stood at 17.9 and 22.9 per cent, and by January 1935 at 23.2 and 27 per cent. During the course of 1935

1 Anything approaching a true account of the agios applied during the 1933-35 system of differential rates would be nearly impossible, since rates were generally *ad hoc* and each transaction would have to be considered separately. No doubt the Hungarian authorities themselves desired to reveal as little as possible regarding the agios, since, in the first place, it was an open secret that the rates depended as much upon the political or commercial importance, on the obdurateness or the unscrupulousness of particular traders, as upon the character of the trade, and since, in the second place, the pengo depreciation was itself an embarrassing fact. Even in the reports of the League of Nations representative in Hungary (Tyler, Eighth Quarterly Report, November 8, 1933, p. 12) the progressive raising of agios was partly concealed by publishing only inclusive averages from the date of their institution. After the multiple system was formally abandoned, monthly averages were indeed given retrospectively (Tyler, Seventeenth Quarterly Report, January 15, 1936, p. 8), but even so they did not distinguish rates by major categories, such as clearing, compensation, and free devisen, nor, of course, by particular countries and commodities.

the premia rose and the surcharges declined to bring them to the same level at 25 per cent when the differential system was terminated.

Except for the Austrian clearing, which persisted on the old basis, premia and surcharges applied specifically to the *clearings* came in 1935 to be fairly uniformly 22 per cent for finished products, 20 per cent on semi-finished goods, and 18 per cent on raw materials on the export side, and 18, 20, and 22 per cent respectively for these three categories on the import side. This uniformity arose from the insistence of each foreign country that it be subjected to no heavier surcharge than its competitors on sales in the Hungarian market, but the "uniformity" is limited to ordinary commodities in the clearings only, and the many special commodity categories and special combinations of rates made it largely illusory, as we shall presently see. The resulting rates seldom completely expressed the real pengo depreciation, and during the years 1933-1935, save for two notable instances, Hungary had adverse balances in the clearings. Indeed, in the case of Austria, the high pengo rate, coupled with the temptation to draw artificially high bills of lading on the part of Hungarian importers and Austrian exporters alike, caused unused pengo balances to pile up in Budapest even early in 1934. The progressive accumulation of these sums throughout that year and the next finally required the abolition of par-clearing in favor of premia and surcharges on exports and imports, as a part of the general reform of December, 1935. The clearing with Germany, after the introduction of the "New Plan" there in the autumn of 1934, and the Italian clearing, after the launching of the Ethiopian campaign, were exceptional in showing favorable balances for Hungary.

During the second period of exchange-control history, three clearings which had functioned poorly caused resort to the cruder device of compensation, with Czechoslovakia, Rumania, and Bulgaria. Hungarian authorities explain that the devaluation of the Czech Krone on February 19, 1934, not being followed by any significant rise of prices, made the existing clearing untenable. Instead of revising the rates through premia and surcharges, the Hungarians went over to the daily *quid pro quo* of a compensation system with Czechoslovakia on July 12, 1934. Trade with Yugoslavia had been on this basis since the institution of exchange control, and the addition of Rumania somewhat later completed

the countries of the Little Entente. Clearing with Bulgaria was terminated in favor of compensation on July 1, 1934. Compensation with the Entente countries was carried on through subsidiary companies of the Hungarian General Credit Bank with offices in Piaig, Bucharest and Belgrade, standing in a correspondent relation to the home office. Besides advising traders as to the possibilities of arranging barter and interpreting the maze of regulations, quotas, and special conditions, it is significant that these companies did a real banking business in financing exports. The maintenance of running accounts obviated the necessity of a strict balancing for each separate transaction, and curiously in effect rehabilitated clearing under private auspices. All transactions required, of course, the consent of the National Bank, which imposed certain norms, *e.g.*, that trade with Jugoslavia should approximate a 1:1 ratio of exports and imports, or that Rumanian imports should consist of 50 per cent of wood, 17 per cent of fuel, 33 per cent of oil. Officials of the General Credit Bank maintain that profits on compensation do not exceed what commissions would be under free payments, outsiders, however, regard the business as very lucrative, particularly because of special rates obtained on "additional" exports.

The distinguishing characteristic of the second period extending through 1933, 1934, and 1935 is that literally thousands of pengo rates came into being, for, besides the clearing premia and surcharges and the decidedly *ad hoc* rates authorized for compensations, there were special rates applicable for particular categories of goods, unique rates on "additional" exports, the use of Sperrpengo at their distinctive quotations, to say nothing of differences arising merely from considerations given one trader in comparison with the next. Importing was less complex than exporting, but such charges differed between large commodity categories and between groups of countries. Imports from Germany at one time under the clearing paid an 18 per cent surcharge for raw materials, 22 per cent for half-finished goods, and 25 per cent for finished goods, and about the same rates prevailed for other clearing countries except Austria, for which the old gold parity was maintained. Payments in devisen to free-exchange countries bore a fairly uniform 40 per cent surcharge at the same juncture, though dollars cost 35 per cent and Swiss francs only 25 per cent more than par.

Foodstuffs, however, paid uniformly a 60 per cent import surcharge, they were "charged what the traffic would bear"¹

The multiple rate scheme had been put into operation on the theory that in Hungary's particular situation price discrimination would yield a larger return than uniformity to allow such export premia as were "necessary" with the depressed world market for agricultural products would be to give greater premia than many other classes of Hungarian exports required. The theory underlying this policy is subject to later enquiry, here we observe merely that, with a change in underlying conditions, the theory was abandoned. Most significant was the world-wide revival in the price of agricultural products and a progressive closing of the "price shears" between agriculture and industry.² For Hungary this meant an increased inflow of foreign devisen and a steadyng of

1 (Cf. "Das ungarische Wahrungssystem," *Die Borse*, August 22, 1935.) Exports revealed unending differentiation of rates. Being a peculiarly "exportable" commodity, goose liver paid no premium. Living fish brought a 9 per cent premium on 70 per cent of the devisen received from free-payment countries, with no premium, i.e., the official rate, on the remaining devisen surrendered. Paprika brought a 20 per cent premium on 15 per cent of the devisen, if exported to France, a 16 per cent premium on 100 per cent of the devisen, if exported to Germany. For seeds exported to Germany no premium was paid, because of the high prices obtained, but the exporter had to couple these sales with sales to other countries where the official rate of the Hungarian National Bank produced losses.

With the further complication of special rates for "additional" exports, the premia assumed for the layman something like the appearance of astronomical physics. Certain standard articles in the additional export category followed general rules according to country of destination, for example, salami sold to Italy fetched a 20 per cent premium, to Holland and to Albania, 35 per cent. Exports of fat, however, commanded an 18 per cent premium if sold to Germany, for England, a 50 per cent premium was paid on the 40 per cent devisen receipts which had to be surrendered to the National Bank, while 60 per cent of the proceeds could be taken by the exporter in discounted Sperrpengo and redeemed at par. Further complications were produced by the existence of special export subsidies. Exports of processed foodstuffs might secure premia in this fashion: a 35 per cent premium on 20 per cent of the price in devisen under the "raw material" subsidy, offsetting losses on imported raw materials, a 60 per cent premium on 50 per cent of the price in devisen under the "groceries syndicate" quota, offsetting the general handicap of high costs of production in Hungary, finally, if the export was "additional," the remaining 30 per cent of the price might be taken in Sperrpengo, thus supposedly extending sales beyond the quantity "naturally" absorbed by foreign markets. To attempt a measure of the effects of such procedures as these upon Hungarian trade would resemble an attempt at a statistical survey of the effects produced by stirring an ant-hill with a stick.

2 Cf. p. 99 below.

pengo quotations abroad¹ The encouragement from these gains on the positive side and the nuisance and uncertainty on the negative side combined to move the Hungarian authorities to a simplification of rates and a liberalizing of payment arrangements during late November and December, 1935, the beginning of the third historical phase of exchange control in that country

The simplified scheme involved five main categories as follows

Category	Premia for Exports	Surcharges for Imports
1 Clearing countries except Austria	38%	41%
2 Free exchange countries	50%	53%
3 "Devisen-compensation" as applied to Germany	18%	19%
4 Austria	10%	13%
5 Compensation countries	<i>ad hoc</i>	<i>ad hoc</i>

The rates which may be taken as basic are the 50 and 53 per cent premia and surcharges on free currencies, approximately the premia paid for gold in pengo currently. For clearing countries, including after the middle of January, 1936, Belgium, France, Switzerland, and Turkey (besides Austria), the 38 and 41 per cent rates represent a much closer approach to the market relation than the 18-25 per cent rates previously applied, the persisting margin below free-exchange premia and surcharges being explained by the restricted applicability and delays in realization of clearing balances. While the rates under clearing and free-exchange categories were approximately justified, the premia and surcharges on Austria were undoubtedly too low, as the subsequent accumulation of Hungarian debts demonstrated. The figure for Austria was arrived at by deducting from the 38-41 per cent rates on clearing countries the 28 per cent agio on free devisen which had established itself in Austria after *de facto* devaluation. But the resulting 10-13 per cent premium and surcharge did not sufficiently recognize the depreciation of the pengo, for since the end of 1933, when pengo and Schilling depreciations were approximately equal, the index of Hungarian wholesale prices indicating the course of export prices had risen by 18 per cent, whereas the Austrian index, even of sensitive prices, had advanced by only two per cent.² As for the Mark, which had depreciated by about one-fourth as against a

1 Cf pp 102, 103 below

2 Cf Fig 12, p 92

one-third depreciation of the pengo, the Hungarian premium and surcharges of 18 and 19 per cent seem to be approximately correct, though an overvaluation of the Mark later developed from the retention of these rates. A new term, "Devisenkompensation," which made its appearance at this juncture, coupled with the announcement that the Hungarian and German banks were to set the exchange rate daily, created the impression that something approaching a free rate was being introduced. Actually, since the rates were not so adjusted, devisen compensation proved to be merely another name for clearing. It came to be known also that the 18-19 per cent rates for Germany were quietly departed from for certain commodities.¹ However, it was not the clearing rates, but rather the policy of Germany in systematically exploiting the clearings, which lay behind a balance of 25,000,000 pengo in Hungary's favor by June, 1936.² After eight months more of "favorable" trade balance, the Hungarian authorities are said to have threatened in August, 1937, to sell their Mark balances at any price necessary to clear the market. Instead there was introduced the "Loro system," providing that, beyond a certain accumulation of Mark balances, the Reichsbank's Hungarian account was to accept payments only if equal payments for German exports were made into the German account in Budapest.³

Despite undoubted benefits to the volume of foreign trade attending the rate simplifications of early 1936,⁴ Hungary made

1 Basler Nachrichten, January 11, 1938

2 Economist, June 20, 1936, p. 673

3 Georg Káldor, Georg Kemény, Josef Vágó, *Die Volkswirtschaft Ungarns 1938* (Budapest, 1939), pp. 192-193. Hereafter referred to as *Volkswirtschaft*, 1938.

4 The rate simplifications were far from being as thoroughgoing, however, as might be inferred from the schedule given on p. 98. It has never been divulged to what extent the simple scheme was departed from, but an indication may be obtained from the following data supplied to me by the National Bank of Hungary for one sample commodity on a given day:

PREMIA GRANTED ON THE EXPORTS OF EGGS ON MAY 15, 1936

In the French clearing	20	per cent
In the Italian clearing	17 5	per cent
In the Swiss clearing	22	per cent
In compensation transactions with Czechoslovakia	34-35	per cent
In "free" trade	38	per cent
In the case of additional exports	85-88	per cent

The consensus amongst competent observers seems to have been that there was nevertheless a substantial amount of uniformity, after January, 1936, and that it had a salutary effect on Hungarian trade.

slight progress during the year on other methods of simplifying or reducing exchange control, largely because of uncertainties preceding the gold-bloc devaluations. Though other members of the Little Entente — Czechoslovakia and Rumania — remained on a mixed scheme of clearing and compensation, Jugoslavia was put upon a "devisen compensation" or clearing basis on January 15, 1936, with uniform premia and surcharges of 45 and 46 5 per cent. The term was also applied to an arrangement with Italy of November 19, 1935, though actually it was a complex mosaic of varying systems, Hungarian grain exports being applied to the amortization of her commercial debts, certain commodities being automatically, others by permission, admitted to clearing, without public announcement of any uniform rates of exchange.¹ Trade with France during the first three quarters of 1936 proceeded on a makeshift basis over the old clearing modified to provide the application of 75 per cent of Hungarian export proceeds to commercial debts as a *quid pro quo* for a 30 per cent reduction in the principal by French creditors. During the same period Hungary was obliged to devote two-thirds of her export proceeds with the Swiss to the amortization of commercial debts. The substitution of a payment for a clearing agreement with Belgium on July 15, 1936, marked the first of several steps toward a slight relaxation of exchange control during the ensuing year.

The gold-bloc devaluations in late September, 1936, interrupted current trading until, after prolonged negotiations, the Hungarians were able to strike agreements with clearing partners as to the exchange rates to be applied. Had the devaluations been mechanically countered by an equal devaluation of the pengo in the form of premia and surcharges, these agios on foreign currencies would have had to be advanced very sharply. By way of illustration, a foreign devaluation of one-third on a currency carrying a 40 per cent agio in Budapest would have required a 210 per cent agio.² In point of fact, the agios were advanced much less — for France and Switzerland from 38 and 41 per cent to 50 and 53 per cent, for Czechoslovakia from 40 and 43 per cent to 45 and 46 5 per cent, and for Italy, where the rates had not previously been

1 Tyler, Seventeenth Quarterly Report (January 15, 1936), p. 10.

2 To offset a one-third devaluation abroad the pengo would have to be devalued by a reciprocal advance of agios, thus, $3/2 \times 140$ per cent = 210 per cent.

announced, from a lower level to 40 and 43 per cent at first and to 47 and 48 per cent later. The relatively high level of domestic prices in the gold-bloc countries previous to devaluation makes it appear improbable that a full meeting of their exchange-rate reductions was necessary. But it also seems improbable that the Hungarians sufficiently devalued the pengo in these clearing relations, for in the year following exports to the five countries involved dropped by 16 per cent in relative share of total Hungarian exports, while imports rose by five per cent.

When the Swiss clearing agreement expired on March 31, 1937, transition measures provided for the liquidation of Hungarian debts, and a payment agreement providing for a free account in the Hungarian National Bank, with the settlement of balances in free devisen, supplanted the old clearings. On April 19 clearing came to an end with France, payments being carried on similarly by free accounts in the two national banks and by settlement of balances in free devisen. Two further steps in the liberalization of trade appeared in the transfer of Bulgaria and Turkey on April 20 and July 1 from the category of compensating to clearing countries. Thus the year and a half of strong economic revival in Hungary from early 1936 to mid-1937 witnessed the institution of devisen payments with Belgium, France, and Switzerland, the abandonment of barter for clearing with Rumania, Bulgaria and Turkey, and, as we shall see presently, the culmination of liberalizing efforts, after the debt regulation in the summer of 1937, in the resumption of free-exchange debt service.

The fourth epoch in Hungarian exchange control, characterized by effective transfer of the debt service but also by a decline in volume of production from the mid-1937 peak, has brought only one measure which could be considered as a continuation of the more liberal exchange policy begun in the third period. On January 15, 1939, the depreciation of pengo currency was recognized in a formal way in the "writing up" of National Bank gold and devisen reserves by 50 per cent, corresponding to premia paid on free devisen. In relations with foreign countries, nearly all the foreign trade agreements of the previous period have been renewed without noteworthy change.¹

1. Clearing with Italy, which functioned poorly in 1937 because of Italian measures to exclude Hungarian cattle and the requirement that a portion of Hungary's wheat exports be paid for in free devisen, has repeatedly been the subject of prolonged negotiations, yielding nothing but an extension,

ECONOMIC DEVELOPMENTS UNDER EXCHANGE CONTROL

A Money, Production, Prices, and Exchange Rates

The financial and economic history of Hungary under exchange control is dominated by the successive phases of world depression and recovery. As a symbol of these phases, we take four major movements in Hungarian wholesale prices, represented in Figures 11 and 12¹ (1) from July to the year-end 1931, relative stability in wholesale prices in the face of sharply declining prices abroad, reflecting the financial crisis in Hungary and the rapid depreciation of the pengo, (2) from January, 1932, to September, 1933, gradual decline in wholesale prices attending agricultural depression and the collapse of industrial production, (3) from the last quarter of 1933 to the third quarter of 1937, a rise in Hungarian wholesale prices deriving chiefly from the improvement in world agricultural prices and economic recovery generally, (4) after the closing quarter of the *status quo* to June, 1939 (Volkswirtschaft, 1938, p. 194). The Rumanian clearing agreement had also to be modified as a consequence of Rumanian protests against the sale of lei balances by Budapest banks at what was considered to be such high rates as to penalize Rumanian exports. An agreement valid until March 31, 1939, fixed the rate at 26 5-27 lei to the pengo, increased the Rumanian Bank's free balance with the Hungarian National Bank, and extended the petroleum quota — for which Hungary had always to pay in free devisen — from 30 per cent to 40 per cent (Volkswirtschaft, 1938, p. 195). Hungarians have continually protested that the requirement of payment in devisen is onerous. By far the most important change in the foreign trade situation has been the absorption of Austria and Czechoslovakia into Germany. By the Hungarian-German agreement of May 7, 1938, all Austrian import quotas were transferred to Germany. The establishment of the Schilling-Mark relation at 3 2, with its consequent imposition of the Mark overvaluation on Ostmark trade, has quite naturally raised Hungarian exports and decreased imports, the former from 17 per cent to 18 per cent of total Hungarian exports, the latter from 18 per cent to 11 per cent of total Hungarian imports, or a 35 per cent decline from 1937 to 1938. Complaints are especially noticeable in Hungary because of the high price and sharp reduction of imports of Austrian wood (I. Ferenczi, "Ungarns Handelspolitik," *Ung Wirt Jhrb.*, Vol. 14, pp. 175-177).

¹ Pp. 91 and 92. For comparative purposes the index of sensitive prices of the Hungarian Institute for Economic Research has been reproduced in Fig. 12. While this index does show a number of short, sharp movements, it fails to show as satisfactorily as the wholesale price index the larger changes in depression and recovery. The Institute may have excluded agricultural and industrial staples from its sensitive index because of the existence of monopolies or controls, but these elements were overridden by cyclical forces, according to the evidence of the wholesale index, which does include such staples. Prices included in the sensitive index are cowhides, calfskin, tallow, beefgut, bones, rapeseed oil, muslin unbleached and prints, iron wire, scrap-iron, brown coal.

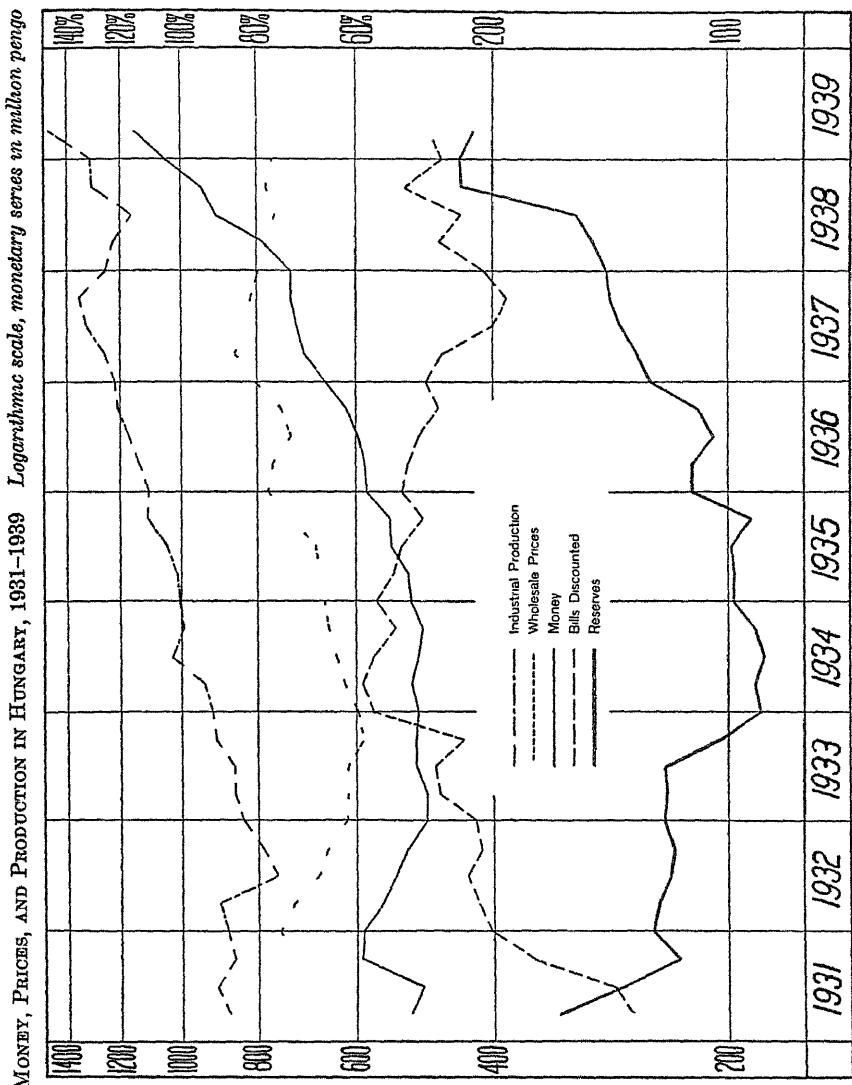


Fig 11 * Left-hand scale money, and bills discounted. Right-hand scale, lower half central bank reserves, upper half percentages for the indices of production, and prices Index of production 1929 = 100
Index of wholesale prices 1925-1927 = 100 * For data and sources, see pp 361-365, below

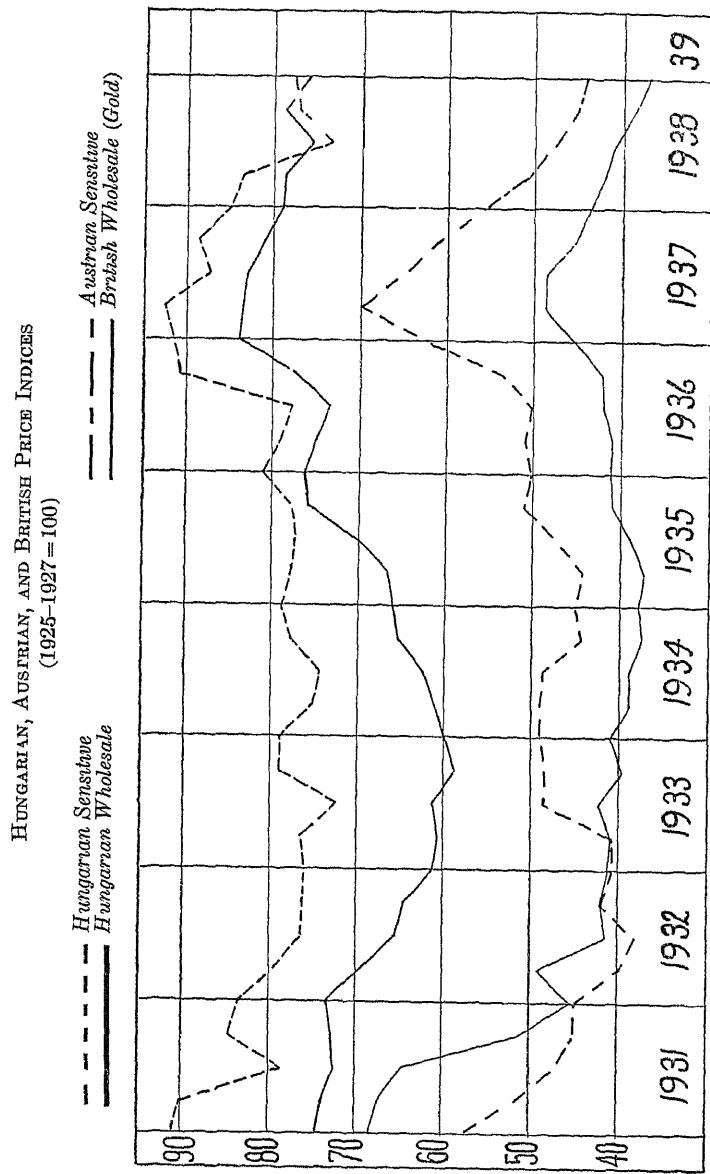


FIG. 12*

* For data and sources, see pp. 353-355, 363-365, below

ter of 1937, a fall and indecisive rise in prices accompanying the set-back and recovery of the last year and a half.

The incisive action taken in 1931 by the Central Corporation of Banking Companies and the central bank in rescuing commercial banks from the consequences of capital withdrawals preserved banking liquidity at the cost of the monetary standard. Despite a rediscount rate of nine per cent in force until September 10 and eight per cent during the rest of 1931, central bank credit increased from 500,000,000 to 600,000,000 pengo and bills discounted from 275,000,000 to 400,000,000 pengo during the second half year. Part of the increase in money supply was dissipated into hoards and part merely provided for the additional requirements of a liquidation crisis, as a result the index of wholesale prices remained stationary. Meanwhile, however, sterling-bloc devaluation and deflation in other countries significant for Hungarian trade—Czechoslovakia, Germany, and Switzerland—left the pengo “high and dry” in a situation of relative inflation. Fig 12 shows a fall from May to December in English wholesale prices on a gold basis from 66 to 44 per cent. The premia on gold in the free Budapest market, as shown in Fig 13, moved reciprocally, except for the sudden spurt in November, to the British price index. At the same time, black market quotations on gold currencies such as the dollar showed approximately the same movement as the price of bullion.¹ International price comparisons and gold-currency premia indicate a one-third depreciation of the pengo by the close of 1931.

Even during these first few months of exchange control, the maintenance of the old pengo parity began to entail certain disadvantages which became chronic maladies of the system. For example, the 1931 wheat harvest, chief staple of Hungarian export, was marketed abroad at a total value of 40,000,000 pengo in comparison with 42,000,000 pengo for the 1930 harvest, despite a 50 per cent increase in physical quantities sold.² A fall of 14 per cent in the price of Hungarian wheat on Hamburg and Liverpool markets accounts for a small share of this discrepancy, but much the larger share must be ascribed to the penalty on exports involved in the low official price of foreign currencies. In the second place, we

¹ E.g. in late December the dollar (old par = 571 pengo) was quoted at 83—85 pengo, i.e. at a 47 per cent premium, while gold sold at a 53 per cent premium.

² U.I.F.W., Vol. 41, p. 90.

INDICATORS OF THE FOREIGN VALUE OF THE PENGÓ

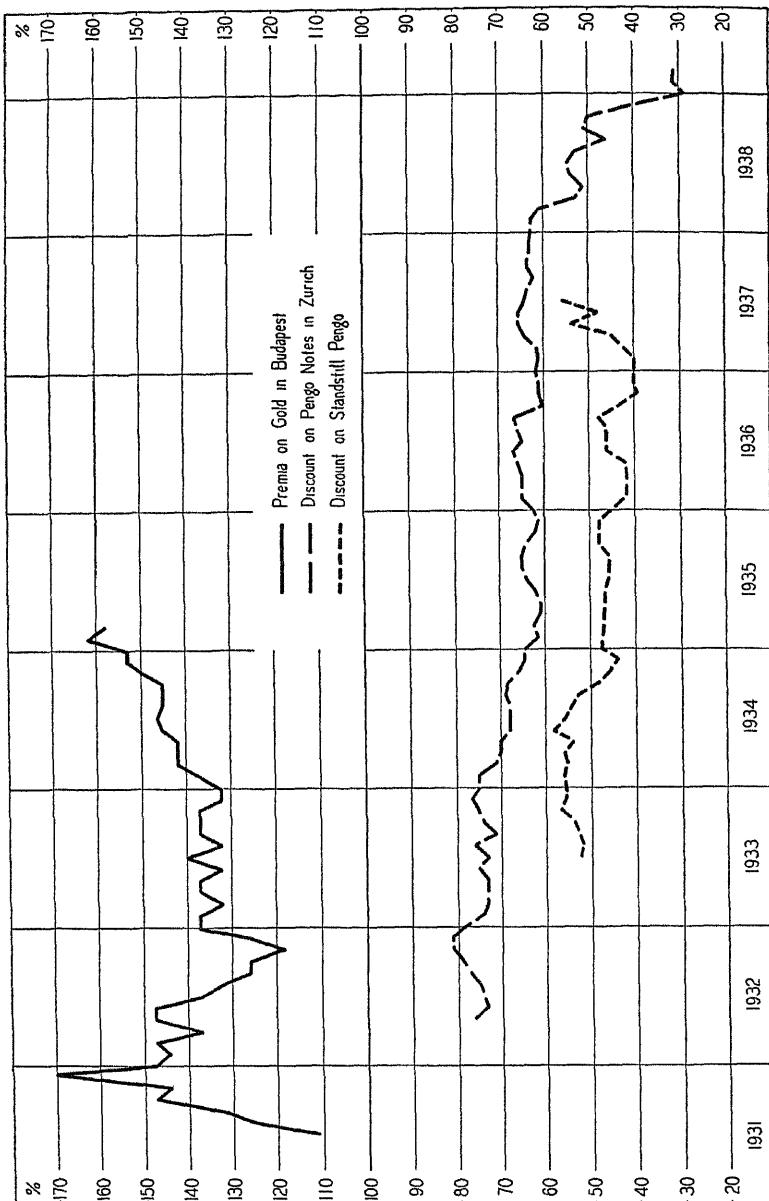


Fig 13* * For data and sources, see pp 137, 366-368, below

observe how the limited allocation of import devisen afforded to certain industries a degree of protection from foreign competition exceeding that which resulted from protective tariffs alone. The cotton textile and coal industries began to experience boom conditions, and the stimulus spread to nearly all cartelized industries in

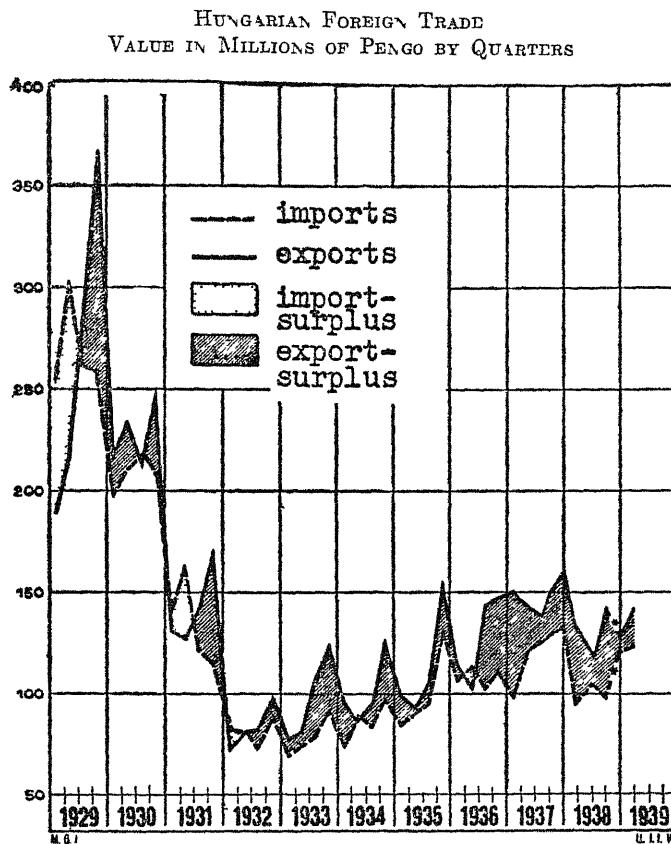


FIG. 14*

* For data and sources, see p. 369, below

the early stages of exchange control. For those industries not possessing certificates enabling them to retain export devisen for the purchase of raw materials, the National Bank's key for allocating exchange caused severe shortages of raw materials, and this came to be the third main source of economic difficulty.

Partly as a consequence of declining world prices for agricultural products, partly because of the pengo penalty on exportation, and partly from the scarcity of raw materials, the Hungarian excess of exports fell from 88,300,000 pengo in 1930 to 31,000,000 pengo in 1931, but this year of catastrophic decline was not yet the lowest point, as shown in Fig. 14. The export surplus in 1931 thus amounted to little more than a tenth the estimated annual debt service of 300,000,000 pengo. It is difficult to imagine a monetary policy sufficiently deflationary to have developed the requisite surplus. Exchange control had been practically unavoidable because of capital flight, and moratorium — decreed on December 22 — was similarly inevitable because of the impossible burden of debt service.

The moratorium marks an end of the crisis phase of depression and the beginning of nearly two years of deflation, financial liquidation and economic stagnation. From its panic level of 170 per cent, reached during the preceding month, the Budapest price of gold came in January, 1932, to assume a level slightly under 150 per cent, which persisted for the next half-year. From Fig. 12 it will be seen that Hungarian sensitive and wholesale prices fell as rapidly as the Austrian sensitive price index and even more than British wholesale prices on a gold basis. Pengo depreciation and the loss of central bank reserves came to a definite halt. Although the National Bank increased its portfolio slightly to the mid-year, total central bank credit (notes and deposits) decreased. The decline in the index of industrial production in these months undoubtedly reflects the world depression and, more particularly, the low levels of agricultural prices and the poor harvest of 1931,¹ but Hungarian commentators ascribed part of the difficulty to inadequate allocations of import devizén and a shortage of industrial raw materials.

The isolation of exchange control as peculiarly responsible for the throttling of industrial production in the first half of 1931 has some justification, inasmuch as the upturn in the second half of the year was accompanied, as we have already noted, by increasing departures from the official pengo prices. From the angle of general monetary policy, however, the second half of 1932 was characterized by an intensification rather than any lessening of credit restriction and liquidation. Bank rate was indeed reduced four times, on April 18 to six per cent, on July 1 to five per cent, and on

1 Cf p. 370, below.

October 18 to 4½ per cent, but bills discounted maintained their former level and central bank credit shrank to 500,000,000 pengo in comparison with nearly 600,000,000 pengo a year earlier. However this development may be judged for its effect upon the domestic economy, it strengthened the foreign position of the pengo. Hungarian wholesale prices continued downward in the second half-year, while British wholesale prices, indicative of price movements in countries not under exchange control, ceased falling altogether. Gold premia in Budapest and the Zurich notation on pengo notes moved reciprocally to one another and were virtually consistent in showing a reduction in pengo depreciation from somewhat less than one-third to approximately one-fourth in the course of the year, as may be seen from Fig. 13.¹ Despite the narrowness of the gold and pengo-note markets, their mutual consistency and the fact that pengo-note quotations in Zurich were paralleled quite closely by the discounts on Standstill pengo seem to indicate that they were fairly reliable indicators of the foreign value of the pengo.

The first three quarters of 1933 found the Hungarian economy "bumping along the bottom" in the final stage of depression. Under the combined influences of depression, exchange control, quotas and tariffs, exports and imports came to their lowest ebb in the first quarter of 1933 at 26 per cent and 23 per cent of their 1925-27 values. Dominated by the world prices for agricultural products, the index of wholesale prices shows the trough of depression, reaching its minimum in September at 58 (1925-27 = 100) in comparison with 71 at the initiation of exchange control in August, 1931. Although the government instituted numerous measures to counteract deflation — borrowing 15,000,000 pengo from the Foreign Creditors' Fund, fostering the foundation of an "Institute for Industrial Rationalization" with an initial 15,000,000 pengo capital for immediate undertakings, intermediating in 25,000,000 pengo of new credits by the Central Banking Corporation to agriculture

1 Both the Budapest gold market and the Zurich market for pengo notes were somewhat narrow and artificial. As for the former, gold could not legally be sent out of the country, and its sole legal use consisted in its serving as a liquidity or hoarding medium. The Zurich market for pengo notes existed chiefly by reason of the fact that, unlike the German authorities, the Hungarians did not attempt to interfere with reimportation of the notes. The supply came from smuggling out currency, chiefly for the purpose of repatriating Hungarian securities (cf. p. 145 below, Tyler, Twenty-third Quarterly Report, July 15, 1937, p. 12), while the demand came from travelers to Hungary.

— the total of central-bank credit nevertheless remained constant throughout the year at 500,000,000 pengo¹. The year 1933 also shows a remarkable constancy in indices of the foreign value of pengo currency quotations on the Budapest free gold market hovered about a premium of 35 per cent, and pengo notes sold on the Zurich market at a discount of about 25 per cent, the slightly more favorable prices in the latter market being easily accounted for by large profits made in bond repatriations financed through smuggling out pengo notes².

The recovery of industrial production beginning in the third quarter of 1932 and carrying forward steadily throughout 1933 (the seasonally adjusted index rose from 75.6 to 91.3 per cent) was not only exceptional in the generally adverse conjuncture, but actually anomalous and artificial. Had exchange control operated in a "pure" form and in isolation, the official rate on foreign currencies would have entailed low yields on agricultural exports — such, indeed, as were actually realized — but it would have exposed industrial production for the home market to devastating foreign competition. Agios over the official rates, introduced for dealings in devisen late in 1932 and extended to clearings during the following year, averaged less than half the 35 per cent premium on gold, they reduced but fell far short of eliminating the bonus to importation. But exchange control did not operate in isolation, beside the ordinary import tariffs, an extensive system of import prohibitions and quotas protected industry at the cost of agriculture. According to the League's Representative in Hungary, by April, 1933, import licenses covered 86 per cent of the total.³ Furthermore, industrial cartels undoubtedly fared much better.

1 The sudden increase of bills discounted in the last quarter of 1933, as observed in Fig. 1, represents no increase of loans, in conjunction with an agreement on October 18 between the Hungarian National Bank and the Bank for International Settlements regarding the consolidation of the emergency credit secured in the summer of 1931, the National Bank had returned to it 126,000,000 pengo of discounted bills formerly in the hands of the European central banks which had granted the loan. At the same time 17,800,000 pengo was transferred from gold and devisen reserves to a special amortization account. Cf U I f W, Vol. 22, p. 19 and Tyler, Ninth Quarterly Report (December 30, 1933), p. 7.

2 Cf p. 361 below.

3 The percentage of imports subject to license in April, 1933, was given euphemistically in terms of 1930 imports! Tyler, Sixth Quarterly Report (April 26, 1933), p. 16. This percentage (44.5) for 1930 imports equals 86 per cent of 1933 import values.

than unorganized and usually smaller competitive industries in securing certificates for the retention of devisen and in obtaining allocations for raw material imports. To offset some of these buttressing forces on monopoly price, in December, 1932, attending the official introduction of agios on devisen, importers had to give a written pledge not to raise prices, but in a period of generally falling prices, such a measure would of course be purely nugatory. Furthermore, a decree of January 7, 1932, established a Price Fixing

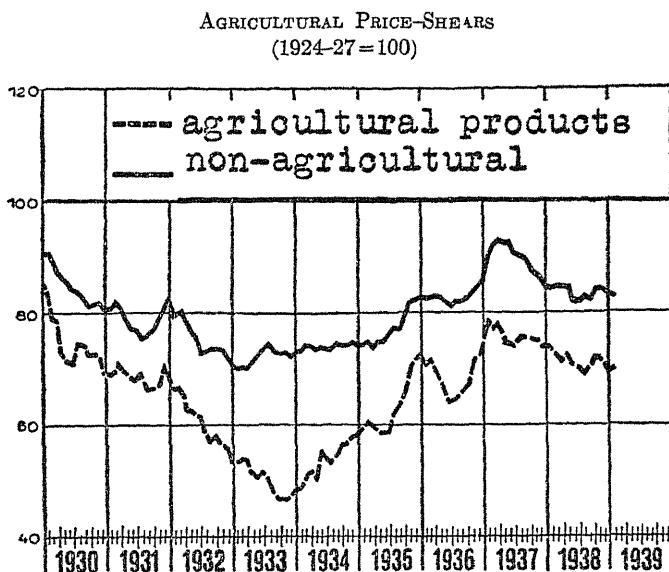


FIG. 15*
* U I f W , Vol 41, p 72

Commission, but the wording of the decree created the impression that 1931 price relations were to be taken as "normal."¹ Another decree on January 23, 1933, made explicit a cost-of-production test of justified price, apparently without avail.

The one fact of overwhelming importance to the Hungarian economy during the whole period of depression was the opening of the "agricultural price shears," i.e. the decline of agricultural

¹ Stefan Varga, "Probleme der Preispolitik," Pester Lloyd, January, 1934.

relatively to industrial prices depicted in Fig 15 Under the artificial maintenance of cartel prices through tariffs, quotas, and exchange control on the other side, their decline being worsened by the penalty on exports from the official exchange rate and the throttling of active balances with clearing partners, the price disparity between industry and agriculture came in the last phases of depression to be the greatest in Europe¹ Since industrial production accounts for a share of the national income not exceeding one-fourth, these relative handicaps laid upon agriculture must be charged with grave responsibility, quite aside from the inevitable workings of the world agricultural situation, for the 40 per cent shrinkage of Hungarian national income in the depression²

Economists who rely upon each country's combatting depression for itself by means of an expansionist monetary policy may well consider the case of Hungary In the first place, Hungary's chief difficulty was not less than full employment, but low international values upon her products Employment statistics for agriculture show a reduction in unemployment from 1935 to 1938 from 10½ to 4 per cent, the reduction is ascribed,³ however, even in these years of strong recovery in Hungary, not to a genuine absorption of unemployed factors but merely to a spreading of the work The ten per cent figure probably represents merely frictional and voluntary unemployment It is difficult to see how credit expansion could have done more than raise costs and domestic prices of agricultural products, lowering the effective foreign value of the pengo Even from the beginning of the depression in 1929, Hungarian industry enjoyed a favored position at the expense of domestic consumers and agricultural interests The seasonally adjusted index of industrial production, as shown in Fig 11, did not fall below three-fourths its 1929 level, in 1932 the Hungarian index assumed third place after England and Sweden among the ten most important European countries Had the central bank and Treasury followed a vigorous program for increasing money incomes, it seems probable that the competitive strength of Hungarian agriculture upon world markets would have suffered, and that industry would have lost more through the impairment of farm purchasing

1 Tyler, Tenth Quarterly Report (April 26, 1934), p 13

2 Matthias Matolcsy and Stephen Varga, *The National Income of Hungary 1924-25 to 1936-37* (London, 1938), pp 68-69

3 Sudost Economist, Vol 1, No 5, p 141 (May 26, 1939)

power than it gained through "pump priming" activities directly

Although the government, perhaps because of such reasons as these, did not launch on a systematic effort at reflation, its own financing was not deflationary. Budgetary deficits of 229,500,000 pengo, 179,700,000 pengo, 108,500,000 pengo and 66,300,000 pengo in fiscal years from 1930-31 to 1933-34¹ served to increase the flow of monetary incomes, since a large share went into agricultural relief and other purposes of "social legislation." It must also be emphasized that, though the operation of the monetary system, including central bank and commercial bank² credit, was on the whole deflationary, Treasury borrowings from the National Bank approximately doubled from 1931 to the end of 1933.³ The 30,000,000 pengo increase was simply overwhelmed in the general liquidation, which reduced central bank money (notes and deposits) from 600,000,000 pengo to 500,000,000 pengo. Finally, other measures taken by the State against depression bore an expansionist character — the reductions of bank-rate primarily as an aid to agriculture,⁴ the establishment of a National Credit Senate to set maximum interest rates on all categories of indebtedness,⁵ thereby reducing the service of agricultural debts by 51 per cent from 1931 to 1934, the extension of "Green Credits" on crops,⁶ and the limited moratorium on short-term agricultural debts proclaimed on April 1, 1932, and extended for two years on October 12, 1935.⁷

The story of economic recovery in Hungary from the last quarter of 1933 to the last quarter of 1937 can be told rather

¹ Ibid., p. 297.

² Statistics of commercial bank credit have not been reproduced here, because of the fact that the use of cheques is so limited as to render the principle of "system expansion" of little importance. "Current accounts" at the close of 1938 only slightly exceeded the 1,050,369 pengo of cash, central bank notes and its own deposits. The figure of current accounts showed an almost absolute inflexibility from 1929 to 1939. Cf. U I f W, Vol. 41, p. 46.

³ Cf. p. 361, below.

⁴ Österreichischer Volkswirt, Vol. 25, p. 312.

⁵ Pester Lloyd, January 1, 1935, p. 16; The Stock Exchange Gazette (London), May 18, 1934, p. 1125-1127.

⁶ Pester Lloyd, February 28, 1933.

⁷ U I f W, Vol. 20, p. 113; Tyler, Eighth Quarterly Report (November 8, 1933), pp. 14-16; idem, Sixteenth Quarterly Report (October 30, 1935), pp. 9-10. For a complete report of Hungarian government measures for agricultural relief, see International Institute of Agriculture, The World Agricultural Situation for the years 1931-32 to 1935-36 (Rome, 1932 to 1936).

briefly, because it is so completely dominated by the improvement in world agricultural markets. Monetary policy, quotas, and exchange control operated as cause and effect, but in either rôle they are subordinate. National income follows the course of agricultural income so closely¹ that Fig. 16 may be taken as showing

THE PURCHASING POWER OF AGRICULTURE
(1924/25—1926/27 = 100)

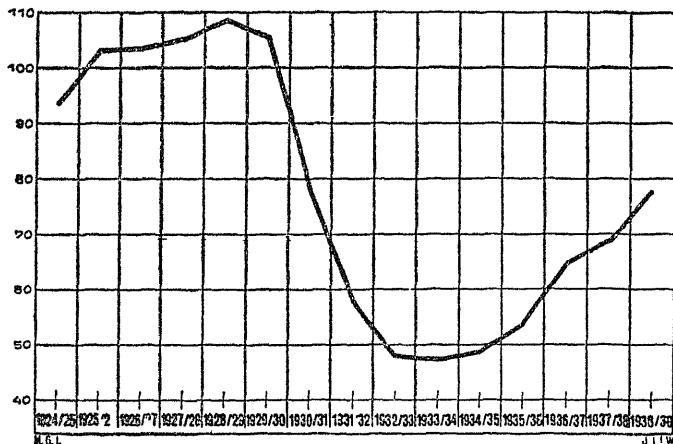


FIG. 16*
* U I f W, Vol 41, p 72

the variations of both Industrial production, which began to advance earlier than in most countries, and which outstripped other countries in growth rate to mid-1937, excepting Japan, Germany and Sweden, had a pyrotechnic quality, but it did not "call the turns."

Recovery began in the last quarter of 1933 as it became apparent that, despite a one-third drop in the Liverpool price of wheat in three months, the 1933 harvest would be large enough to insure a larger value yield than the preceding year. There was, moreover, an increase in industrial exports under the stimulus of the Martins Agreement for "additional exports" against frozen pengo.² The year closed with a favorable trade balance of 78,700,000 pengo, or

1 Matolocsy and Varga, op. cit., p. 69

2 U I f W, Vol 24, p. 126

only one-tenth less than 1929, the largest of post-war years. The favorable balance of 1933 reacted strongly upon expectations throughout the Hungarian economy the following year. Wheat prices in Budapest almost doubled, much exceeding any rise explicable from the poor harvest, since Liverpool quotations closed the year at the same level as prevailed at the beginning. Export prices as a whole rose from May to November by 22 per cent, and, despite a three per cent fall in the British wholesale index, the Hungarian index advanced by six per cent.

The consequence of this ten per cent rise of prices relatively to gold currency countries was a depreciation of the pengo from a level of three-fourths to a level of two-thirds of parity gold premium in Budapest (cf. Fig. 13, p. 94) advanced from about 35 per cent in 1933 to 53 per cent by the end of the year, while pengo notes in Zurich fell from 75 to 65 per cent of par. The favorable balance of trade declined meanwhile by one-third. Responsibility for these developments rests less with the banking system than elsewhere, since central bank credit remained nearly constant. But the budgetary deficit in 1934-35 advanced to 70,400,000 pengo, carrying with it a tendency to raise costs, government borrowings from the central bank increased somewhat, and the artificial maintenance of grain prices continued. Had the government actually felt the concern regarding the external value of the pengo implied in its retention of exchange control, it would have pursued a more rigorous course in these matters.

However insecure the price advance of 1934, the revival of Hungarian economy during 1935, 1936, and the first half of 1937 was solidly founded upon the improvement in world agriculture. From the low point of depression to the first quarter of 1937, industrial prices rose by only 13 per cent against 45 per cent for farm products. This closing of the "agricultural price shears" goes far in explaining the advance of industrial production from 101.5 (1929=100) to 135.3 and of national income from 3,490,000,000 to 4,227,000,000 pengo over the same period, as well as the reduction of the budget deficit to 34,600,000 pengo in 1935-36 and the appearance of a surplus of 8,100,000 pengo in 1936-37. Second in importance in the recovery were the excellent harvests of 1935 and 1936¹ marketed at good prices because of relatively poor yields elsewhere, circumstances which largely account for the swelling of

1 Cf. p. 370, below.

central bank reserves (cf Fig 11, p 91) from 94,000,000 pengo in September, 1935, to 142,000,000 pengo in September, 1937, and for favorable trade balances of 1935 and 1936 of 49,200,000 pengo and 67,900,000 pengo

In contrast with 1934, the first year of recovery, when the pengo lost a tenth of its foreign purchasing power, the gradual climb of the wholesale price index from 1935 to the turn of activity in 1937 did not outstrip the advance of British prices (cf Fig 12, p 92), and the external value of the pengo appears to have suffered no deterioration as measured in gold premia and the discounts on pengo notes and Sperrpengos in Zurich (cf Fig 13, p 94). That the entire upswing was financed from hoards and current savings¹ is evidenced by the continuous reduction of bills discounted by the central bank and the increase of its notes and deposits at a rate not exceeding accretions to its gold and devisen reserves (cf Fig 11, p 91). Monetary ease, frequently characterized as stagnation in the money markets, prevailed throughout by virtue of its isolation from other capital markets — such as Germany — bank-rate could be kept at four per cent from August 29, 1935 onward, and the whole structure of interest rates could be held at the low levels of that year. The culmination of four and a half years of economic gains came in 1937 with a national income equalling that of 1930, industrial employment exceeding 1929 by ten per cent, a balanced budget, and the resumption of debt service in free devisen. Inconsistent with what would be the normal expectation for recovery, and ominous for an approaching downturn, was the trebling of National Bank advances to the Treasury from 1934 to 1937.

The current phases of the cycle began with a turn in wholesale prices in April, 1937, reflecting a break in Liverpool wheat prices. Prices for farm produce in general declined, but not so rapidly as to prevent the total value of Hungarian exports from increasing over previous years. For agricultural exports in 1938 prices were very low, but Hungary was favored by a record harvest bringing a favorable balance of 104,100,000 pengo, equal to the previous high mark in 1937. Thus, despite the decline of agricultural prices, it has been agriculture which paradoxically supported the economic situation. Hungarian industrial production fell off from 135.3 to 116.2 from the second quarter of 1937 to the third quarter of 1938,

¹ Economist, February 12, 1938, p 20

as compared with 105.1 and 69.1 during the same interval for the United States¹

On the monetary and financial side, steady accretions in 1937 to central bank reserves justified the increase of its credit, especially in view of the declining index of wholesale prices. Developments during 1938, however, were precarious. The absorption of Austria into Germany in March caused apprehensions regarding Hungary's economic future and a withdrawal of 100,000,000 pengo from the banks between March 1 and May 1, met by a corresponding increase of central bank note issue. Before the hoarded funds could return in significant amounts, the second crisis — this time involving Czechoslovakia — precipitated withdrawals of 150,000,000 pengo. Bills discounted at the National Bank increased correspondingly to 567,000,000 pengo by the end of September, but then decline to 479,000,000 pengo a month later indicated the passing of acute panic. The large increase of reserves at this juncture is not real but a mere transfer of 70,000,000 in gold and devisen from "Other Assets" to "Reserves,"² a move which not only reveals the existence of hidden reserves but also betrays a desire for a show of strength at a time when note issue had been increased 60 per cent within a single year. About one-fourth of the increase was, it is true, involved in the exchange of pengo notes for Czechoslovakian currency in the regions taken over by Hungary in November.³

On June 23, 1938, the statutes of the Hungarian National Bank were revised in conjunction with the initiation of the rather ambitious Five Year Plan for public investments aggregating 1,000,000,000 pengo, funds to be provided by a domestic loan of 400,000,000 pengo and the balance by a capital levy. However much certain of the amendments may have been required by "modern conceptions of a monetary standard," such as permission to engage in open market transactions,⁴ the provision of a 130,000,000 pengo credit to the State — an amount nearly equal to central bank discounts for the Treasury in the prosperity year 1937 — arouses suspicion of inflationary fiscal tendencies. Of the 1,000,000,000 pengo provided for in the Five Year Plan (600,000,-

¹ Reichskreditgesellschaft, Germany's Economic Situation at the Turn of 1938-39, p. 32.

² Volkswirtschaft, 1938, p. 225.

³ Note issue was thereby increased in roughly the same proportion as the accretion to population. Economist, December 17, 1938, p. 595.

⁴ Ung. Wirt. Jhrb., Vol. 14, pp. 366-373.

000 pengo for rearmament and 400,000,000 pengo for public works) half had already been spent by the late spring, 1939¹. Industrial production rebounded from 116.2 in the second quarter of 1937 to 147.0 in the first quarter of 1939 under the influence of these heavy public expenditures.

The reappearance of a budgetary deficit of 67,900,000 pengo in 1937-38, the disturbed state of international politics, large increases in the note issue, and the launching of the Five Year Plan have reacted unfavorably on the pengo. After three years of stability extending through even the gold-bloc devaluations of 1936, Zurich quotations on pengo notes fell during 1938 and the early months of 1939 from 60 per cent of parity to 30 per cent (cf. Fig. 13, p. 94). It is difficult to tell how much of this can be ascribed to domestic price level changes, particularly since the cue given by the Budapest gold market has been lacking since early 1935. Until the end of 1938 the indices of both sensitive and wholesale prices moved downward, and even the more moderate movement of the latter equalled the reduction in British wholesale prices, but with the first quarter of 1939 all the price indices of the Hungarian Institute for Economic Research have disappeared in its *Reports*, and their place has been taken by the relatively insensitive indices of the Royal Statistical Office,² a change which is calculated to arouse suspicions. The abrupt fall in the value of pengo notes in Zurich, on the other hand, is probably partly explained by the increase of supply through a flight of capital from Hungary, while the demand for travel purposes has suffered under threats of European war. On the whole, there seems to be a strong probability that the statement which had come to be conventional, that the pengo is about one-third depreciated, now errs decidedly on the side of optimism.

B The Comparative Situations of Industry and Agriculture

The most characteristic feature of exchange control, the maintenance of an artificially low price on devisen, operates to penalize exports and encourage imports. If a country's exports are largely agricultural, agriculture suffers, if its imports are largely industrial, industry flourishes, at least relatively. A windfall to importers

¹ Royal Institute of International Affairs, South-Eastern Europe, A Political and Economic Survey, 2nd ed. (London, 1939), p. 118.

² U I f W, Vol. 42 (May, 1939), p. 52.

of industrial products or to domestic industrialists arises in the first place because, at the artificially low rate of exchange, import devisen have to be rationed out and this entails a reduction in imports and a rise of their domestic prices¹ A second source of windfall or monopoly profits to industry lies in the allocation of devisen for industrial raw materials at the low foreign exchange rates Thirdly, to the degree that industries are monopolized or firms are few and large, they are apt to fare better in securing allocations of devisen, by fair means or foul These three factors *per se* increase the profits of cartels and further the formation of monopolies The hardships to agricultural exporters, on the other hand, induce them to band together to secure modifications of exchange control or better prices for their exports Nothing precludes such export organizations from turning their attention to the possibilities of domestic markets It is to be observed that the greater the divergence between official and "real" rates of exchange, the more potent are all four of these forces Finally, almost as a corollary from these propositions it follows that the consumer must suffer loss

The Hungarian economy under exchange control shows the operation of these tendencies in full force Consider first the position of industry The narrative of economic developments in Hungary under exchange control revealed that industrial production turned upward in mid-1932, two years before the upturn in agricultural income,² that it maintained a fairly even advance for five years thereafter at 12 per cent *per annum*, and that it was, relatively to other countries, rather slightly affected by the downturn of 1937 The superior position of industry arose partly from the "natural" divergence of industrial and agricultural prices in depression, but it was also to an undetermined degree adventitious — the result of protective tariffs, import quotas, and exchange control³

1 The immediate tendency of an artificially low rate on foreign exchange would be toward an *absolute* increase of imports But with given conditions of domestic cost and international demand this rate will necessarily reduce exports and, except for available reserves of devisen which an exchange control country is not likely to possess, reduce imports also

2 Cf Figs 11 and 16, pp 91 and 102 above

3 Some offset to the superior position of industry came from the levying of the "social burden" taxes almost exclusively upon industry, and from the introduction in 1937 of the 44-hour week and minimum wage rates by administrative decree

Chief benefits from these interferences accrued to the cartelized sector. Fig. 17 reveals how the prices of coal, lignite, firewood,

HUNGARIAN WHOLESALE PRICE INDICES INDUSTRIAL RAW MATERIALS
(1927=100)

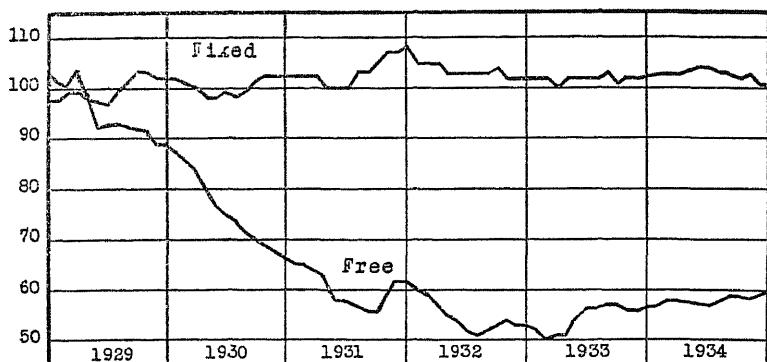


FIG. 17*

*These indices, not previously published, were compiled by Professor Wolfgang von Heller of the Hungarian Institute of Technology. The underlying data are not available for reproduction.

mineral oil, and iron — monopolized industrial raw materials — not only defied reduction throughout depression but even rose slightly, whereas the prices of copper, lead, tin, lumber, briquettes, leather, cotton, wool, linen, and paper — competitively produced or imported industrial raw materials — fell in 1932 and 1933 to 50 per cent of their prices in 1929.

In addition to the five cartelized commodities included in the index, monopolies also controlled fertilizers, gasoline, lime, cement, textiles, alcohol and milk. So notorious was the discrepancy between pegged and free prices that publication of the two series had discreetly to be discontinued by the Hungarian Institute for Economic Research after September, 1932.¹

Of those industries gaining from exchange control in and of itself, glass, leather, paper, and iron are perhaps most notable. Certain cartelized industries such as coal, while benefiting by import restrictions through quota and exchange control, lost on balance, because of reduced demand from heavy industry, espe-

¹ U I f W, Vol 14, p 35

cially in the 1931-32 period of par exchange rates¹. But this very enforcement of the official rate provided an unparalleled stimulus to the textile industry, because of a high proportion of its costs in imported raw materials. As a result, as early as November, 1931, it was especially noted as a booming industry,² similarly in the following quarter, it was the one exception to general economic contraction.³ Despite a fall of 53 per cent in textile import from 1930 to 1931, there was again a 57 per cent decline from 1931 to 1932, but total sales of textiles in Hungary decreased (1931-32) only from 498,000,000 pengo to 408,000,000 pengo,⁴ and number of employees remained at practically the 1929 level throughout the depression. In 1933 a one per cent tax on textile production, calculated to yield 3-3,500,000 pengo annually for purposes of export subsidy, was explicitly justified from the favorable conjuncture created by import limitations.⁵

Throughout the exchange control experience complaints were rife concerning a "shortage of industrial raw materials". In view of the fact that the percentage of total imports falling under this caption increased from 23.6 per cent in 1931, when exchange control was introduced, to 34.6 per cent in 1934, and that it remained at the relatively high level of 31 per cent through 1938, a phenomenon which should cause no surprise in a period of intense autarky, the complaints may seem paradoxical. The explanation is a simple matter: at the low official rate on foreign devisen, amount demanded vastly exceeded amount supplied, however large the imports of industrial raw materials. To some firms, those which possessed importers' certificates,⁶ large concerns and cartels which succeeded in enforcing their claims in the devisen allocation, and those, as for example the iron industry, drawing their raw materials through the clearings,⁷ even this circumstance meant no embarrassment. The complaints emanated mostly from merchants, small industrialists, and agriculturalists dependent upon imported raw materials. As might be expected, a raw material

1 Osterreichischer Volkswirt, Vol 6, No 5, p 87

2 U I f W, Vol 13, p 111

3 U I f W, Vol 14, p 118

4 Osterreichischer Volkswirt, Vol 25, No 43 (July 22, 1933), p 345

5 Wirtschaftsdienst, September 20, 1935, U I f W, Vol 19, p 111

6 Cf p 81 above

7 R P F Edwards, Economic Conditions in Hungary, 1933-35, Department of Overseas Trade Bulletin No 629 (H M Stat Off London, 1936), p 24

shortage in this sense was most acute at times when the exchange rate applied by the National Bank showed largest deviations from "free" rates,¹ as for example in the latter part of 1931 with the enforcement of parity rates.² It is frequently said³ that the shortage of industrial raw materials arose because Hungarian exports went largely to European exchange-control countries not supplying these essential materials. Had there not existed the artificially low rates on foreign devisen, however, windfall profit on imports including this category would have disappeared, and with it the "scarcity" of devisen for less fortunate applicants.

The concave side of the shield is the economic position of agriculture. How the "agricultural price shears" reduced Hungarian agrarian classes to desperate straits, and how in a variety of ways the government attempted to alleviate their difficulties, has been described briefly.⁴ From the viewpoint of exchange control chief interest attaches to the policy of maintaining grain prices⁵ substantially above their international level through the operations of the Futura Company, the Boletta Fund, the Agricultural Relief Fund, and international agreements. The Futura Company, founded in 1919 to aid farmers in marketing, was utilized from 1930 onward to carry through open-market purchases on government account to support grain prices. Throughout the entire period of exchange control, also, the price of Hungarian wheat was maintained above world market levels by international agreements giving the buying countries a *quid pro quo* through an undertaking on the Hungarian side to amortize debts or to absorb certain quantities of industrial exports. An agreement made as early as 1931 with Austria merely offset the effect on Austrian purchasers resulting from a 3.50 pengo per quintal markup on wheat given as a bonus to Hungarian producers.⁶ Under the

¹ As (only approximately) indicated by the black market for devisen, gold market, and Zurich quotations on pengo notes. Cf p. 97, n. 1, above.

² U I f W, Vol. 13 (November 1931), p. 111.

³ For example in Ungarns Handel und Industrie im Jahre 1936 (Budapest, 1937), p. 31.

⁴ Cf p. 101 above.

⁵ Concentration upon grain and neglect of livestock, the next most important Hungarian export, may be explained by the fact that grain prices fell early and violently, whereas livestock breeding actually gained for a while by a shift of consumption to meat. Cf League of Nations, World Production and Prices, 1925-33 (Geneva, 1934), p. 26.

⁶ Österreichischer Volkswirt, Vol. 28, No. 42, p. 1121, and No. 46, p. 1208.

terms of the famous Rome Pact between Hungary, Austria, and Italy, which was put into effect in July, 1934, and renewed annually thereafter, the latter two wheat-importing countries agreed to take definite quantities of wheat at a 'fancy' price in return for Hungarian trade concessions. Though the price was not officially published, it is known to have been 16 pengo per quintal for Austria and 17 pengo, subsequently 18 pengo, for Italy,¹ a price level which, like "dollar wheat," seems to have seized upon the popular imagination as a sort of *justum pretium*. The Liverpool price did not exceed one-third this amount, but even so, under the prevailing obstacles to trade the Rome Pact prices assumed an intermediate position between world markets and the domestic price in European wheat-importing countries.² While the international agreements undoubtedly worked to an undeterminable degree toward grain-price maintenance in Hungary, their results, so far as *quantity* sold is concerned, were generally disappointing.³

The Futura Company and international agreements have been operating during the whole period of exchange control in Hungary, but the Boletta device utilized until 1934 has given place to an Agricultural Relief Fund. After an initial year (1930-31), when the entire proceeds of 3 pengo per quintal went to grain producers, the price of the *boleitta* (ticket), which purchasers were required to buy for each quintal of wheat or rye, went partly as a subsidy to the producer and partly to the government for an agricultural export subsidy fund, if the domestic buyer exported the wheat or rye, the *entire* price of the *boleitta* was refunded. In 1931-32, when the *boleitta* cost 10 pengo,⁴ 6 pengo went to the farmer and 4 pengo to the export subsidy fund. The

1 Foreign Agriculture, Vol 2, 1938, p 105

2 On October 20, 1933, for example, the Budapest price at 7 6 pengo to 7 8 pengo per quintal exceeded slightly the Liverpool price, while the Austrian domestic price equalled 28 2 pengo and the Swiss 54 pengo! Cf. Tyler, Eighth Quarterly Report (November 8, 1933), p 16

3 Details of the Rome Agreements are set forth by Tyler particularly in the following Quarterly Reports Eleventh, pp 14-15, Thirteenth, p 9, Fourteenth, p 14, Nineteenth, p 18, Twenty-second, p 14, and Twenty-fourth, p 14

4 In this year when the farmer's share of the *boleitta* was at its maximum premia had not yet been introduced on export devisen, furthermore, the Hungarian price of wheat was at its lowest level in a century. Cf. International Institute of Agriculture, The Agricultural Situation in 1932-33 (Rome, 1934), p 465

difference between 10 pengo refunded upon exportation and 4 pengo going into the subsidy fund was made up by taxation, the existence of this burden being partly concealed by keeping the Boletta Fund separate from the budget

It has been said that the *boletta* system "did not hamper export, as the bounty was refunded to the exporter"¹ The fallacy of this reasoning lies in its neglecting four important facts (1) Once export bounties are established, margins of cultivation and exploitation assume such a position that the bounty can never be *removed* without "hampering" the export of the subsidized commodities, as Hungary has discovered in being obliged to retain the system to the present day, despite the notable increase in agricultural purchasing power² (2) The absorption of factors of production into the subsidized export raises the costs of other export commodities, a force becoming important as business revival proceeds (3) Export commodities into which the subsidized article enters as a raw material cost more to produce, even in periods of less than full employment³ (4) Finally, as a consequence of these three facts, the foreign value of the monetary unit is maintained at a level higher than can be justified on the basis of comparative costs of production⁴

The farmer's share of the *boletta* was set at 6 pengo, 4 pengo, and 3 pengo for the successive fiscal years of 1931-32, 1932-33, and 1933-34 As we have seen,⁵ the system of premia and surcharges began to be introduced late in 1932, as the high domestic prices were gradually and at least partly compensated for by lowering the effective foreign value of the pengo by agios, the *boletta* could be gradually reduced At the beginning of the new fiscal year in July, 1934, the Boletta Fund was abolished — probably as a gesture to consumer and labor interests — in favor of a system of authoritarian minimum prices⁶ and the "Agricultural Relief Fund," which derived its income, like its predecessor,

1 Tyler, Thirteenth Quarterly Report (December 29, 1934), p 8

2 Cf p 102

3 The high cost of living became a matter of concern in Hungary even in the depths of agricultural depression Cf pp 153-155 below

4 Cf the discussion of pengo rates, pp 90-105

5 Cf p 82 above

6 The minima (15 35 pengo in 1933-34, 14 75 pengo in 1934-35, 20 pengo in 1936-38) served merely to define the amount of domestic subsidy per quintal of Tisza wheat So far as concerns export prices, they had been set by authority from the outset of exchange control

entirely from extra-budgetary sales taxes. The expense of the Funds for four fiscal years beginning with 1933-34 amounted to 75,000,000 pengo, 45,000,000 pengo, 49,500,000, and 51,000,000 pengo, and for the last two years it has remained at about the 50,000,000 pengo level. With these sums may be compared the balances of the State budget, including State undertakings - 76,400,000 pengo - 70,400,000 pengo - 34,600,000 pengo, and +8,100,000 pengo for the years 1933-34 through 1936-37. Subsidy to agriculture in the form of price maintenance alone thus assumed a magnitude comparable with depression deficits on the entire budget.

In November and December, 1935, when the system of differential premia was for the most part abandoned for "straight line" premia for three or four main groups of countries, the wheat premia shortly assumed a level around 50 per cent, the general premium paid on exports to free-exchange countries.¹ This coincidence raises another interesting question concerning causation: does the general export premium determine the wheat premium or does the wheat premium determine the general devisen premium? Obviously since wheat, despite its great significance to the Hungarian economy, does not exceed one-sixth to one-eighth of total exports, causation runs more strongly from devisen premium to wheat premium than vice-versa. To an unknown extent, however, the wheat premium represents an artificially high price for wheat and enters in, therefore, to the maintenance of the pengo at artificially high values, even at existing agios on foreign devisen. The impossibility of quantitative appraisal of this difference rests upon a lack of information concerning relative costs of production of various Hungarian products and their "marginality" as exports.

While industrial countries can readily support the prices of farm products by protective tariffs, this way is closed for countries with an agricultural export surplus. We have observed the expedients to which Hungary resorted: import quotas, interest and tax reduction, moratoria, credit extensions, minimum domestic prices and export subsidies. To these may also be added the toleration of export monopolies for agricultural products. Complete price control came into effect for horses, wine, game and onions, and export syndicates had some degree of control over

1. The wheat premia, as was explained earlier, are those for export to free-exchange or "gold" countries.

the prices of seed, vegetables, eggs, feathers, goose liver, broom straw, dressed poultry, honey, butter, animal fats, bacon, livestock and animal products¹ It is of course impossible to devise a method of measuring the results of this program aimed at lowering costs and raising prices for agriculture In the opinion of technically competent Hungarian observers, however, all devices in the aggregate did not suffice to offset losses entailed by the pengo rate²

Finally, there are important secondary repercussions from the Hungarian attempt to cancel out the pengo rate penalty through artificially maintained grain prices In the first place, the high price of wheat and rye had a tendency to draw along the prices of substitute goods such as clover and maize,³ and this raised the cost to domestic consumers of end-products such as beef, milk and beer In the second place, this circumstance reacted adversely upon exports, particularly upon flour, which had, of course, to carry the heavy cost of wheat The accelerated decline of Hungarian milling, once the largest in Europe, represents one of the most radical of the indirect workings of exchange control,⁴ though Hungarian flour exports had already fallen off in the 'twenties in consequence of European protective tariffs

1 Volkswirtschaft 1938, p 209

2 This opinion was expressed by at least one official of The Budapest Chamber of Commerce, the semi-official Pester Lloyd, The Hungarian Land Mortgage Institute, and the League of Nations representation in Budapest

3 Osterreichischer Volkswirt, Vol 31, p 903

4 Tyler, Tenth Quarterly Report (April 26, 1934), p 15 Volkswirtschaft, 1938, p 108

FOREIGN TRADE UNDER EXCHANGE CONTROL

A *Cyclical and Secular Developments*

Hungarian foreign trade during eight years of exchange control to mid-summer, 1939, has been dominated by two major forces — the course of world depression and recovery, and the restriction of international trade through autarky. Preceding sections have narrated the history of control and have described the course of the cycle within Hungary. Here it may be added that over the cycle Hungarian industrial activity fell less than that of most countries and recovered more¹, but the volume of Hungarian foreign trade declined to a very much lower level than that of most countries and also recovered slightly less, as the table given below shows. Juxtaposition of the volume figures of 74 per

HUNGARIAN AND WORLD TRADE

1929 = 100

	HUNGARY *				WORLD †			
	Imports Volume	Exports Value	Total Trade Volume	Total Trade Value	Imports Volume	Exports Value	Total Trade Volume	
1931	82.3	50.8	82.2	55.4	82.2	52.7	85.5	57.9
1932	44.8	30.8	50.6	32.2	47.8	31.5	74.4	39.1
1933	50.8	29.3	74.1	37.6	62.8	33.4	75.1	35.2
1934	61.8	32.4	72.3	38.9	67.2	35.6	78.6	34.1
1935	69.5	37.3	73.5	43.0	71.5	40.6	82.3	34.7
1936	79.7	40.6	90.6	48.7	85.3	44.7	85.4	37.5
1937	83.8	45.5	106.7	57.1	93.6	50.9	97.0	46.0
1938	73.3	39.4	90.5	50.7	80.9	44.7	85.7‡	39.6‡

* Hungarian trade percentages computed from value and volume figures given in *Statisztikai Negyedévi Kozlemények* (Budapest, 1931–39)

† World trade values in gold, League of Nations, *World Trade*, volume, Institut für Konjunkturforschung, Berlin

‡ For 1938 the figure represents an unweighted arithmetic average of four quarters as reported by *Wirtschaft und Statistik*, Vol 19, No 5, p 178

cent for world trade in 1932 with 48 per cent for Hungary reveals the relative severity of both depression, particularly agricultural depression, and autarkic limitations upon trade for this particular country. Furthermore, the volume of Hungarian foreign trade lagged behind the recovery in world trade during 1937 and

1 While Hungarian industrial production fell to 76 in June 1932, world industrial production reached 69 (1929 = 100, cf L of N, *World Economic Survey 1936–37*, Geneva, 1937, p 76), and while the former rose to 135 in October 1937, the latter rose only to 108 (*ibid*, 1937–38, Geneva, 1938, p 120)

1938 (94 per cent and 81 per cent in comparison with 97 per cent and 86 per cent), despite a notable improvement in the prices of farm products Comparisons upon the basis of *volume* of trade, such as these, indicate much more reliably the relative position of Hungary than do value of trade figures, inasmuch as the statistics of her foreign trade rest upon valuations in official-par pengo¹

The two major forces — business cycle and autarkic trend— come into bold relief again in the composition of trade by commodity groups When *total* exports and *total* imports are divided into raw materials, half-finished, and finished goods, cyclical changes preponderate over the tendency to autarky At the low point of depression in 1933, Hungary experienced the climax

HUNGARIAN FOREIGN TRADE BY GROUPS OF COMMODITIES*

Percentage of Total Exports										
	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
Raw	59.9	59.2	58.2	58.5	64.8	61.8	60.8	61.4	58.9	59.7
Half-										
finished	7.1	8.1	9.8	8.6	7.3	8.7	11.3	10.1	10.5	9.8
Finished	33.0	32.7	32.0	32.9	27.9	29.6	27.9	28.5	30.6	30.5
Percentage of Total Imports										
	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
Raw	37.8	39.2	41.5	42.4	42.1	43.1	47.7	45.2	42.1	41.3
Half-										
finished	22.8	22.6	26.1	28.4	28.7	29.9	27.4	29.1	31.3	28.9
Finished	39.4	38.2	32.4	29.2	29.2	27.1	25.0	25.7	26.5	29.8

* From *Statisztikai Havi Kozlemenek* (Royal Statistical Office, Budapest), Vol 33-42, 1930-39

of difficulties ascribable to relatively high domestic prices, particularly in competition with foreign manufactured goods, so that agricultural products constituted a larger share of exports The gradual progress of recovery in western European countries

1 Cf Tyler, Eighth Quarterly Report (November 8, 1933), p 17 and Ninth Quarterly Report (December 30, 1933), p 11 Because of scantiness of published information concerning premia and surcharges, as well as quantities of import and export against pengo, "additional" exports, etc , it is impossible to deflate the figures to "real" pengo values Published statistics on value of exports and imports give obviously absurd results Thus in 1932, when the volume of Hungarian trade had fallen to 47.8 per cent in comparison with 1929, its value was reported at 39.1 per cent in value If one accepted the official figures, one would have to conclude that despite the relatively great fall in agricultural prices, the unit price of Hungarian trade had fallen to 66 per cent of 1929, whereas the unit price of world trade had fallen to 53 per cent

thereafter reversed the tendency, as foreign industrial costs mounted. On the side of imports following 1929, the gradual disappearance of plant extension and the lowering of standards of living reduced finished imports from 39 per cent to 25 per cent in 1935, but with the revival of Hungarian capital goods industries and the upturn of *per capita* income the share of manufactured goods in imports increased and that of raw materials fell. Even so, in 1938 the former category included only 30 per cent of imports as compared with nearly 40 per cent in 1929 — the fruition of a decade's efforts at industrial self-sufficiency.

If restricted to *industrial* imports, the three commodity groups reveal still more clearly the movement toward autarky:

HUNGARIAN INDUSTRIAL IMPORTS*

Groups as Percentages of Total Imports

	Raw	Half Fin.-hed	Finished
1928	16.1	28.6	55.3
1929	20.2	29.1	50.7
1930	23.8	29.5	46.7
1931	23.6	35.1	41.3
1932	28.3	36.4	35.3
1933	32.3	33.9	33.9
1934	34.6	34.0	31.3
1935	33.8	35.1	31.1
1936	33.9	35.3	30.8
1937	34.9	35.4	29.7
1938	31.0	34.1	34.9

* U I f W , Reports

Eleven years (1928 through 1938) brought an approximate doubling in the share of industrial raw materials, a 25 per cent increase in half-finished imports, and a 37 per cent decline in imports of finished industrial products. The tendency is again observed to have been most marked in the trough of depression, though a subsequent easing did not counteract the general trend.¹ Exchange control, introduced in 1931, merely intensified the pre-existing secular development toward autarky, but it is impossible to measure its influence separately.

¹ Imports by the machine, electrical, iron and other metals, textile, and leather industries, in which autarkic tendencies came to their culmination, represented 44 per cent of total imports in 1926 and 23 per cent in 1935. Cf. Hungarian General Credit Bank, Economic Report, Vol. 10, No. 2 and 3 (February, March, 1936).

Some indication of the relative importance of exchange control in the whole nexus of causation appears, however, in changes in Hungarian trade in 1933 and 1936. It will be recalled that toward the end of 1932 the attempt to enforce official pengo parities was abandoned for a system of multiple premia and surcharges. Whatever the defects of this innovation, it at least narrowed the gap between the nominal and real foreign values of the pengo and consequently brought about a reduction of the artificial stimulus to imports and penalty upon exports. The following year—undoubtedly partly because of the good harvest—brought at one step an increase in the volume of Hungarian foreign trade from 47.8 per cent to 62.8 per cent of the 1929 level, while world trade increased in volume from 74.4 per cent to merely 75.1 per cent.¹ Furthermore, Hungarian exports rose in volume from 50.6 per cent to 74.1 per cent, while imports—as one would expect from the rate changes—increased less, from 44.8 per cent to 50.8 per cent. The next largest upward step came in 1936, when the volume of Hungarian trade increased from 71.5 per cent to 85.3 per cent, though world trade showed a relatively modest gain from 82.3 per cent to 85.4 per cent. Hungarian exports again rose more than imports, the former from 73.5 per cent to 90.6 per cent, the latter from 69.5 per cent to 79.7 per cent. This increase followed the abolition of multiple pengo rates in favor of relatively uniform premia and surcharges, but again the comparison is complicated by the favorable harvest of 1936. Informed observers seem nevertheless to ascribe the improvements in both volume and favorable balance of Hungarian trade in 1933 and 1936 to the changes in exchange control,² and this judgment would seem to be confirmed by the increase, not merely of agricultural exports in the two significant years, but of industrial exports also.³

B Trade by Countries

The question as to the effects of exchange control upon Hungarian trade with particular countries very largely resolves itself into the question of the effects produced by various international

1 Cf the table given on p. 115 above.

2 Pester Lloyd, January 1, 1935, p. 17, Tyler, Seventeenth Quarterly Report (January 15, 1936), Ung. Wirt. Jhrb., Vol. 13, p. 166, Hungarian General Credit Bank, Economic Report, Vol. 11, No. 2,3 (February, March, 1937).

3 Cf U.I.F.W., Vol. 41, p. 67.

arrangements for trade how was trade affected by clearing, compensation and payment agreements? In its answer to the League of Nations questionnaire in January, 1935 concerning clearings, the Hungarian Government replied that 'it is not possible to indicate in figures the effect of these agreements on the movements of goods, which are also influenced by numerous other and more important factors'¹ The answer is perhaps too sceptical, but it is indeed difficult to disentangle the effects of clearings, partly, as the Hungarian authorities held, because of "other and more important factors," but also because of statistical limitations

It is not possible to present a quantitative summary of the historical course of trade under the contrasting categories of clearing, compensation, and free exchange merely from a list of the countries involved in each type of payment arrangement and the statistics of Hungarian trade by countries Complications arise from the shift of countries from one category to another at other intervals than those utilized in trade statistics, from ambiguities of such terms as "Kompensation," "Verrechnung," and "Zahlungsabkommen," from inadequate information concerning the precise dates at which new agreements took effect and the mode of liquidating old balances The one insurmountable difficulty is the fact that trade with one country may, and usually does, proceed partly in each of the main categories, but the amount of trade in each category by countries has never been reported Thus Hungarian wheat exports to Austria and Italy, within certain limits, were paid for in free devisen, though the bulk of trade passed over clearings with barter transactions as an added possibility Hungary had to pay for a certain percentage of petroleum imports from Rumania in free devisen outside the clearing In other cases, such as in Hungarian commerce with Czechoslovakia and Italy, clearing was limited to certain totals, while compensation covered dealings exceeding the limits or not admitted to clearing

To draw any comparison of the directions of Hungarian trade before and after the institution of exchange control it is obviously necessary to ignore changes in the status of a given country during the period of control as well as the other complications mentioned in the preceding paragraph The device usually employed

¹ League of Nations, Enquiry into Clearing Agreements (Geneva, 1935), p 115

is to classify countries under the dominant form of payment arrangement with Hungary as of a given date during exchange control, maintaining the same classification for all years both before and after the termination of free exchange. Such a comparison appears in the following figures.

**HUNGARIAN TRADE WITH CLEARING,
COMPENSATION, AND FREE-EXCHANGE COUNTRIES¹**
(Imports and exports in each category as a percentage
of total imports and exports)

Category of countries	Imports				Exports			
	1930	1931	1933	1934	1930	1931	1933	1934
Clearing	69.0	61.6	70.3	70.6	80.4	77.4	74.7	74.8
Compensation	20.5	28.7	16.2	17.7	12.5	14.6	12.1	12.1
Free exchange	10.5	9.7	13.5	11.7	7.1	8.0	13.2	13.1

The years 1930 and 1931 effectively represent the situation before clearing and compensation began, since the Czech, Swiss, and Austrian clearings were in operation for only 2 months, 1 month and 15 days, respectively, at the end of 1931. Because the process of introducing clearings extended throughout 1932, this year is omitted. The years 1933 and 1934 represent the foreign trade of Hungary when clearing and compensation were extended to a total number of countries not subsequently exceeded. On the whole, the comparison of 1930–31 with 1933–34 reveals a strong inflexibility in Hungarian trade with each of *these particular groups of countries*. But it is only from this one angle, as will later become apparent, that one can agree with the Hungarian authorities in reporting to the League that "clearing agreements were not able to exercise a decisive influence on the movements of foreign trade."²

Though trade by *countries* grouped by predominant mode of

1. The classification is based on the relation of Hungary to other countries as of September 1934. Cf U I f W, Vol. 24, p. 44. Under clearing come Austria, Belgium, Czechoslovakia, France, Germany, Italy, and Switzerland, under compensation Bulgaria, Denmark, Greece, Jugoslavia, Poland, Rumania, Spain, and Turkey, and under free exchange, all other countries. Percentages computed from Hungarian trade by countries in League of Nations, International Trade Statistics (Geneva, 1933), p. 142, and ibid., (Geneva, 1935), p. 138.

2. The increase of *exports* to free exchange countries, which seemed to rejoice some Hungarian commentators, failed to bring any increase — there was actually a decrease — of free devisen as a percentage of total *payments* to Hungary, because the difference went to legal and illegal debt repayments. But cf. p. 122.

payment showed no particularly noteworthy alterations through the advent of exchange control, there did occur important changes in relative amounts of trade paid for in different ways. Statistics of payments for exports and imports under the separate heads of clearing, compensation, pengo payment and free devisen are available only for Hungary, Austria and certain other countries to which the League of Nations appointed economic and financial advisors.¹ What these figures reveal is that exports and imports

METHODS OF PAYMENT FOR HUNGARIAN EXPORTS AND IMPORTS*

Exports	Main Categories as Percentage of Total					
	1932	1933	1934	1935	1936	1937 I-VI
Clearing	42.4	47.5	58.8	59.8	61.1	61.3
Compensation	24.3	21.5	15.2	15.5	18.0	15.1
Total of clearing and compensation	66.7	69.0	74.0	75.3	79.1	76.4
Export against pengo	1.8	10.3	10.0	5.1	3.6	4.6
Free devisen obtained	31.5	20.7	15.0	19.7	17.3	19.0
Imports	1932	1933	1934	1935	1936	1937 I-VI
Clearing	45.3	51.8	62.4	64.4	66.2	66.5
Compensation	30.1	28.7	18.3	18.7	19.9	18.3
Total of clearing and compensation	75.4	80.5	80.7	83.1	86.1	84.8
Devisen applied	24.6	19.5	19.3	16.9	13.9	15.2
Imports against marketable pengo			(6.5)	(1.4)	(8)	(10)
Free devisen disbursed			(12.8)	(15.5)	(13.1)	(14.2)

*Annual averages from quarterly percentages as given in the Reports (1932-37) of U I f W. The improbability of seasonal variation in payment methods permitted the striking of an unweighted average.

passing through the clearings increased persistently as a share of the total for the five years 1932-36. So persistent was the increase that, despite the reduction of compensation deals, the percentage for clearing and compensation taken together increased also — for exports from 67 per cent to 79 per cent and for imports from

1. Unfortunately, through the merging of clearing payments with those made in free devisen, and of compensation with payments in pengo, the elaborate statistical matter published by Tyler in his Quarterly Reports to show "the results of exchange control," is practically useless. The same concealment of free devisen payments characterizes the summaries given in Ung Wirt Jhrb., Vol. 14, pp. 363-364. I have drawn upon the much more illuminating figures published by the Hungarian Institute for Economic Research.

75 per cent to 86 per cent. The decline in amount of exports yielding free devisen rigidly limited Hungarian importers in their choice of sources of supply. This adverse tendency asserted itself despite the avowed aim of the Foreign Trade Commission and the Foreign Trade Office to encourage exports to free exchange countries,¹ and also despite the exchange control reforms of 1932 and 1935.

Responsibility for the marked trend toward a smaller percentage of total payments to Hungary in the form of free devisen is borne partly, in the first place, by the spread of exchange control even after 1931. Most of these new countries were unimportant individually in Hungarian trade, but their collective and indirect effects were not negligible, and Italy, going over to really drastic exchange control in 1934, was third in importance in Hungarian exports and fourth in imports. Furthermore, the gradual reduction of gold reserves throughout continental Europe led to a diversion of imports to clearing countries such as Hungary. Finally, since Hungary had a favorable trade balance with her most important creditors, these countries could exploit their debtor position on current account to secure the earmarking of increasingly large shares of Hungarian export proceeds for the liquidation of old debts, a circumstance which caused bitter recrimination on the side of Hungary.

Latest developments show no improvement in the portion of Hungarian trade yielding free devisen. For the last period reported in detail, the first half of 1937, clearing and compensation declined slightly in favor of free devisen in both exports and imports.² An estimate for 1938, however, puts clearing and compensation at two-thirds with a further addition of 90,000,000 pengo as partly free or covered by gentlemen's agreements limiting the availability of devisen.³ The conclusion of payments agreements including Belgium, Switzerland, and France during 1936 and 1937 failed to work any noticeable betterment, simply because trade with these countries did not exceed 5 per cent of the total. In conclusion it may be observed that clearing and

1 Cf p 82 above

2 Cf p 121

3 *Volkswirtschaft*, 1938, p 192, cf also R P F Edwards, Report on Economic and Commercial Conditions in Hungary, 1935-37, Dept of Overseas Trade, No 697 (H M Stationery Office, 1938), p 203

compensation covered from 8 per cent to 10 per cent less on the import side, because exports of wheat to Austria and Italy brought free devisen

Very significant changes in Hungarian trade appear from a separation of exports¹ into geographic regions, though the influence of exchange control in this respect is probably secondary. The

HUNGARIAN EXPORTS BY GEOGRAPHIC DISTRIBUTION*

1925-30 1929 1930 1931 1932 1933 1934 1935 1936 1937 1938

Immediately adjoining countries†	61.9	57.2	53.8	43.3	46.4	43.2	37.4	31.3	28.3	26.7	29.4
Germany and											
Italy	17.8	18.6	23.2	22.5	23.0	19.8	30.4	37.1	36.1	36.3	36.1
Other											
countries	20.3	24.2	23.0	34.2	30.6	37.0	32.2	31.6	35.6	37.0	35.5

*Compiled from *Statistikai Havi Kozlemenek*, Vol. 24-41

†Austria, Czechoslovakia, Rumania, Jugoslavia. The figure for 1938 does not include Austria in Germany

proportion of Hungarian exports going to adjacent countries — Austria, Czechoslovakia, Rumania, and Jugoslavia — fell by half over the decade 1929-38, exports to Italy and Germany doubled from 1933-38, and exports to "other countries" increased by half from 1929-31, thereafter maintaining about this level. The abrupt drop in percentage of exports to adjacent countries came in 1931, when exports to Czechoslovakia dropped from the 1930 share at 16.8 per cent, giving to this country a rank second only to Austria's, to 4.2 per cent and a rank of sixth or seventh in Hungarian exports. This cataclysmic decrease, explained by the lapse of the commercial treaty with Czechoslovakia at the end of 1930, was never made good, and it is precisely this decrease which gave to "other countries" the sharp gain in their share of Hungarian exports from 23 per cent to 34.2 per cent, subsequently neither reversed nor intensified.

Another cataclysmic change appears in the strong gains made by Germany and Italy in 1934 and 1935 at the expense of the four countries immediately adjoining Hungary. By one bound exports to Germany doubled from 1933 to 1934, both in absolute magnitude (43,700,000 pengo to 89,500,000 pengo) and in relative

1 Changes on the side of imports simply reflect the diversion of exports analyzed in the text, or change in a fashion to suggest the operation of no general forces

importance (11.2 per cent to 22.2 per cent) A new trade agreement, initialled on February 21 and put into force on April 1, 1934, providing wider opportunities for Hungarian agricultural exports,¹ paved the way for this movement, but the real impetus seems to have come from the Work-Creation program in Germany, with its increased demand for raw materials in general² and more particularly for foodstuffs demanded by newly employed laborers.³ Furthermore, because of the superior bargaining position of Germany,⁴ it would be natural to expect some favoring of exports to this country through the system of differential exchange agios then in force in Hungary, though the lack of published rates prevents confirmation of this belief. The German gain of 1934 was followed next year by a sharp increase of exports to Italy from 8.3 per cent to 13.5 per cent of the Hungarian total. In May, 1934, Italian exchange control had been tightened, and in July, 1934, the Rome Agreements of Italy, Austria, and Hungary had been ratified. With the outbreak of the Abyssinian War it was quite natural that Italy should draw her imports more extensively from clearing countries, particularly from Hungary, which declined to join in the League of Nations sanctions. But within the last eighteen months the change of greatest significance has been the absorption of Austria and Czechoslovakia into Germany. From 1937 to 1938 exports to the Altreich alone increased from 24 per cent to 28 per cent and imports from 26 per cent to 30 per cent of the Hungarian totals. In the first quarter of 1939 Greater Germany took 95 per cent of Hungarian meat export, 88 per cent of the hogs, and 75 per cent of the grain. The portentous political and economic significance of this situation is worthy of especial emphasis.⁵

Discussions of Hungarian trade under exchange control have so frequently referred to a tendency of exports to go to "distant"⁶

1 Tyler, Tenth Quarterly Report (April 26, 1934), p. 18.

2 Ungarns Handel und Industrie im Jahre 1936, pp. 22-25.

3 Á v Meccsér, "Die Rückwirkungen des Anschlusses auf die Beziehungen zum Deutschen Reiches," *Ung Wirt Jhrb.*, Vol. 14, p. 23.

4 Whereas Germany constituted a fifth of the market for Hungarian products, they account for only two per cent of German imports. In this sense cf. also Mark Mitnitsky, "Germany's Trade Monopoly in Eastern Europe," *Social Research*, Vol. 6, pp. 22-39.

5 The *New Statesman and Nation*, Vol. 17, No. 432 (June 3, 1939), p. 850.

6 Hungarian General Credit Bank, *Economic Report*, Vol. 9, No. 10-11 (October, November, 1935), Tyler, Third Quarterly Report (July 15, 1932).

or even to "far distant"¹ countries that the idea became a shibboleth. Actually no non-European country figures prominently in Hungarian trade, and amongst European countries which might be thought of as "distant" such as England, Belgium, France and the Netherlands, there was no tendency for their share of Hungarian exports to increase under exchange control. If by "distant" one should mean simply Italy and Germany, we have already observed the persistent gain of these countries at the expense of the four countries adjoining Hungary, and the 10 per cent loss on the export side suffered by all six of the near and contiguous countries in comparison with "other countries." The latter change actually came before exchange control, and the growth of exports to Italy and Germany derived from a tendency toward a political entente with these countries, favorable trade agreements, the German work-creation program and the Italian war in Africa, rather than from exchange control. It is true of course, as Hungarian authorities have maintained, that in the absence of clearings and compensations, neither country could have drawn heavily upon Hungarian agricultural supplies. But political enmities and alliances play the largest rôle. To Austria and to the three remaining contiguous countries, which constituted the former Little Entente, Hungarian exports averaged 61.9 per cent over the period 1925-30, even by 1930 they had fallen to 53.8 per cent and by 1931 before the clearings came into operation to 43 per cent, on the other hand, the share of Germany and Italy rose from an average of 17.8 per cent during 1925-30 to 23.2 per cent in 1930 before the advent of exchange control, remained unaffected in 1932 by the introduction of clearing, and experienced its great augmentation in 1933-35 with the development of present political alignments.

Finally, we may observe the behavior of Hungarian trade with the most important of her creditor countries.² From 1930 to 1931 Hungarian exports to these countries increased in absolute amount by 11 per cent and in relative share of her total exports

p. 12, *idem*, Tenth Quarterly Report (April 16, 1934), p. 15, *idem* Twelfth Quarterly Report (October 13, 1934), p. 10, League of Nations, World Economic Survey 1933-34 (Geneva, 1934), p. 149

¹ Hungarian General Credit Bank, *loc. cit.*, Vol. 11 (February, 1937), Tyler, Twenty-Fifth Quarterly Report (February 26, 1938), p. 5

² Cf. figures for exports, imports, and balances with France, United States, England and Switzerland, p. 371, below

from 12 per cent to 22 per cent, at the same time capital *inflows* from these very countries continued at 210,000,000 pengo for 1930 and 287,000,000 pengo for 1931, despite the conversion of the small unfavorable balance of trade in 1930 with the creditors into a large favorable trade balance in 1931! Under free exchange, such as obtained while most of these funds were moving, there is no necessity that as between two countries goods should move on balance in the same direction as capital. Yet there would be *some* tendency of this sort, a movement of goods directly contrary to the capital movement is unusual.

The explanation of this situation seems to lie in the fact that the outward movement of values had more powerful and intimate connections with commodity trade than did the much larger movement of funds inward. In response to pessimistic anticipations arising from the catastrophe to agricultural prices, Hungarian nationals engaged in a capital flight by exporting to the financially strong nations and taking payment in foreign currency and securities. As depression deepened, inventories and all things available for export were sacrificed to the flight into safer currencies. Foreigners who had made direct investments in Hungary may have withdrawn inventories and even some equipment. Capital flowing into Hungary, on the other hand, went largely into state and municipal improvements which competed with export industries only remotely for raw materials and factors, or into liquidity reserves, such as the Bank for International Settlements loan to the Hungarian central bank, which did not operate to raise costs.

Exchange control, including clearings, effectively stops repayments *via* third countries, after 1931 it would be natural, therefore, to expect a direct association of capital and commodity movements. Lending to Hungary ceased in 1932, and repayments by means of "additional exports" had scarcely begun the neutral trade balance which actually appeared in that year fulfills expectations. After 1932 the expected favorable balances with creditor countries likewise were realized, their size depending upon the phase of the cycle within Hungary.

Hungarian exports turned strongly toward England and Switzerland during 1931, for as countries with a reputation for "sound" currencies they attracted a large part of the substantial pengo export balance developed by flight capital in that year. Expectations are also confirmed in the decline of Hungarian

exports and the increase of imports from particular countries after their devaluations, as in the case of trade with England in 1932 in comparison with 1931, and with Switzerland in 1937 and 1936. Finally it is to be observed that, though France was quantitatively half again more important than England as a creditor of Hungary, the favorable balances which Hungary developed in maintaining debt service for France were a small fraction of those for England. The French quota system seems to have purchased protection for domestic producers at a heavy cost to French foreign lenders.

C Export and Import Prices Terms of Trade

In the introductory chapter it was argued on purely *a priori* grounds¹ that the introduction of exchange control and clearings would raise costs and prices in international trade exports would bring higher (gross) prices, if sold to clearing rather than to free-exchange countries, and imports from clearing countries would cost more than if they were purchased from free-exchange countries. It is strange that the League of Nations Report on Exchange Control restricted its argument to the side of exports, but fortunately for present purposes the statistical verification for exports happens to be drawn from the case of Hungary. Furthermore, the League appears to have had more complete trade statistics at its disposal than those published by the Royal Hungarian Statistical Office, in which the quantity of, and total price paid for, a particular export is not always given for each country. The figures of the Report are particularly valuable, therefore, for their inclusion of all countries for several of Hungary's most important exports. Prices in several cases are 50 per cent higher for exports

HUNGARY AVERAGE EXPORT PRICES OF CERTAIN ARTICLES, 1936*
(In Pengo per Quintal)

	To Exchange Control Countries	To Other Countries	To All Countries
Wheat	16.01	11.15	14.09
Wheat flour	22.70	12.96	18.53
Chickens, etc	132.0	87.0	118.0
Fresh butter	198.0	115.0	158.0
Eggs	89.0	70.0	87.5
Malt	23.49	18.68	19.68
Rye	12.69	8.51	12.63

*League of Nations, Report on Exchange Control (Geneva, 1938), p. 34

1 Cf pp 24-26

to clearing countries, and for wheat flour the margin exceeds 75 per cent. The extent of these differentials and the exhaustiveness of the figures as to countries seem to leave no doubt that in 1936 Hungarian trade fulfilled the theoretical expectation.

However, if the price differentials had antedated exchange control — price differences resting upon differences in quality, in method of quotation, in “terms” allowed the purchaser — the evidence of 1936 would be inconclusive. To explore this possibility, I have carried back the calculation of export prices for three of the commodities in the Report to 1931, before clearings were established. The very restricted size of the sample is explained by the necessity of selecting commodities of standard quality and by

Commodity exported	PRICES OF HUNGARIAN EXPORTS TO CERTAIN FREE AND EXCHANGE CONTROL COUNTRIES*							
	1931	1932	1933	1934	1935	1936	1937	1938
<i>Dressed poultry</i>								
England	185.7	117.7	113.4	97.8	85.9	84.6		
Germany	194.0	143.8	122.3	109.2	122.1	126.5		
<i>Butter</i>								
France 1931-33	280.7	169.8	135.5	65.0	109.9	114.4	135.0	135.9
England 1934-38								
Germany	276.0	199.9	157.4	203.0	197.9	204.4	211.0	204.7
<i>Flour</i>								
England	28.0	23.0	15.8	18.0	11.8	13.0		
Czechoslovakia	26.8	23.0	21.7			28.0		

*Compiled from data of volume exports by countries in quintals and total value of specific commodities exported to given countries, as given in *Statistikai Havi Kozlemények*, Vol. 36-41.

the fact that, even in the most exhaustive trade statistics published, it is practically impossible to discover complete series of both volume and value of exports by commodities by specific countries. However, in the case of the three commodities for which somewhat interrupted series could be shown there is no instance in which the tendency of export prices to exchange-control countries (Germany or Czechoslovakia) to exceed export prices to free countries (England or France) is explained by a price differential existing before the introduction of clearings. Furthermore, although the samples include only single countries in either category in contrast with the League's figures including all countries, the figures show also that the year 1936, the only one pre-

sented by the Report, is not an isolated case or a mere accident

On the side of imports, not included in the Report, limitations such as those encountered for exports restrict the figures presented here to mere illustrative examples. Average prices paid for raw

PRICES OF HUNGARIAN IMPORTS FROM CERTAIN FREE
AND EXCHANGE CONTROL COUNTRIES*
(Average Prices in Pengo per Quintal)

Commodity imported	1931	1932	1933	1934	1935	1936	1937	1938
Raw coffee								
England	140 0	155 0	130 3	121 1	78 9	78 1	91 2	67 2
Germany	140 0	180 0	145 7	121 1	85 2	106 5	126 1	128 9
Anthracite coal								
Poland	3 50	3 50	3 50	2 78	2 57	2 56	2 30	2 30
Germany	3 50	3 51	3 48	2 96	3 10	3 08	3 05	3 19
Cocoa beans								
England				44 2	43 0	53 0	74 4	50 3
Germany				44 2	43 0	51 0	88 0	62 2

*Source as on p. 128

coffee imports began in 1931 with absolute equality, but immediately thereafter revealed the *a priori* expectation that more would have to be paid to the exchange-control than to the free-exchange countries. For the single year 1934 coffee prices again came to equality when, under the operation of the so-called Swedish clause, Germany extended her imports without extra expenditure in devisen, and was consequently in a position to offer some commodities at reduced prices, but with the abrogation of Swedish clause agreements in 1935 the original tendency reasserted itself, and by 1938 Hungary was actually paying double the English price for its coffee imports from Germany. In 1934 and 1935, while Poland still maintained freedom of payments, her anthracite coal cost Hungary less than Germany's, thereafter the same relation persisted, undoubtedly because of Germany's ability, as overwhelmingly the greatest market for Hungarian exports, to drive a hard bargain.¹ Figures are not available for cocoa-bean imports

1 The opinion is expressed in the Royal Institute of International Affairs, South-Eastern Europe, pp. 196-200 that Germany either did not strive or at any rate did not succeed in utilizing her mere size as an importer to turn the export-import price relation in her favor. The evidence for this contention is that for a number of southeast European countries following 1933-34 export prices rose relatively to import prices. The recovery of agricultural relatively to industrial prices is quite forgotten!

into Hungary in the early years of exchange control, and they show no marked changes from 1934 through 1936, but in 1937 and 1938 the expected rise in cost of German supplies to Hungary puts in its appearance.

The evidence given in the League Report and the further indications adduced here support the generalization that, as applied to Hungary, exports bring higher gross prices and imports entail higher costs in trade with exchange-control than with free-exchange countries. Though the terms of trade may be shifted in these price changes by differing cost and demand functions, there can be no *a priori* certainty as to which country, as between two exchange-control countries, will gain or lose. But the terms of trade are only half the story when volume of trade is also considered, the ordinary tendency of clearings to enforce an equality of exports and imports by levelling downward, makes it practically certain that both countries derive a smaller gain from international trade.

As between a free-exchange and a clearing country, or as between the situations of one country before and after the institution of exchange-control, the foregoing evidence would show that the second situation involves a loss even in terms of trade. For since clearing raises the cost of imports, and since there is no reason for believing that import costs in the free relations should fall, the average cost of imports must be raised for the country under clearing arrangements. On the side of exports, the higher gross prices would mean a reduction in net prices except in the limiting cases of demand and cost functions which throw the interest and risk costs of sales through the clearing entirely on the buyer. The probability of this constellation is small. Consequently clearing involves losses in both terms and volume of trade, if comparison is made with free exchange.

The Hungarian Institute of Economic Research publishes a monthly and annual index of the prices of exports expressed as a

HUNGARIAN EXPORT PRICES AS A PERCENTAGE OF IMPORT PRICES*
(1925-27=100)

1929	92 0	1933	81 8	1937	94 4
1930	90 4	1934	94 4	1938	97 0
1931	84 7	1935	102 9	1939	
1932	85 4	1936	98 0	April	92 0

*U I f W , Vol 1-42

percentage of the prices of imports, the so-called "foreign trade price shears." Over the years 1929-1935 the fall and rise in Hungarian terms of trade as measured by this index follow the collapse and recovery of agricultural prices relatively to industrial prices, and whatever adverse effects exchange control may have had are submerged in this major movement. But since the agricultural shears continued to close from 1935 to 1937,¹ it would be reasonable to conclude that the adverse movement in Hungarian terms of trade in 1935, 1936, and 1937 rests directly upon exchange control and other autarchic devices. The implications of this deterioration, either natural or induced, in the "gain from trade" appear with catastrophic severity in the matter of foreign debt.

FOREIGN DEBTS UNDER EXCHANGE CONTROL

The introduction of exchange control in 1931 was occasioned for Hungary as for other countries by withdrawals of foreign capital threatening the collapse of the monetary standard. We have already followed early developments — the stop-gap prohibition of all outward capital transfers under the exchange-control decrees, and the petrifying of long-term debts under the Moratorium of December, 1931. Since the Moratorium, unlike the Standstill on short-term foreign debts, was a matter of one-sided action, it included the entire body of long-term debts (2,470,736,088 pengo), exempting only the League Reconstruction Loan of 1924. Amortization and interest were maintained on this loan until August, 1932, for the following year service had to be suspended entirely, and thereafter only interest was paid, half in exchange and half in coupons or blocked pengo. With this exception and one per cent interest on the Bank for International Settlements loan, Hungary paid nothing in devisen upon its foreign obligations until 1937, and even where transfer was made indirectly by "additional exports" and so forth, interest alone and at reduced rates was paid. The first renewal of the Moratorium in December, 1932, carried with it one-sided reductions in nominal interest to 5 per cent, the renewal of the Moratorium was simply made by annual decree thereafter.

Hungarian debtors paid the pengo equivalent of sums owing to foreigners on long-term debt — principal and interest — into

1 Cf p. 103 above

a "Foreign Creditors' Fund"¹ with the Hungarian National Bank. Except for interest service on the Bank for International Settlements and League loans, disbursements from this fund were made into "Blocked Inland Pengo Accounts" held by authorized Budapest banks to the credit of foreigners. Utilization of blocked pengo held by foreign owners under the Moratorium depended upon permission of the Hungarian National Bank, in fact, the use was limited with some exceptions to defraying expenses incurred by the owner through travel or residence in Hungary.² On the basis of permitted uses, these so-called "coupon pengo" or "coupons" were traded in at varying percentages of parity on the chief foreign markets at Zurich, Amsterdam, and London. If, as in December, 1933, the coupons sold at 73.8 per cent of par, a 5 per cent bond yielded effectively 3.69 per cent, if, as in November, 1936, coupons sold at 30.3 per cent, the yield dropped to 1.52 per cent.

So far as obligations of the State, embracing about half of Hungary's foreign long-term debts, are concerned, payments into the Fund came to be a mere formality. From the Autumn of 1932 to June, 1933, the government fell into arrears to the Fund by 34,400,000 pengo, thenceforth it constantly increased the amount which was paid by means of Treasury bills, as may be seen from the statistical summary in the Appendix,³ relying as a matter of fact exclusively upon this method. But even this financing entailed a less than proportional burden upon government credit, inasmuch as, from about the same time onward, the Fund advanced to the Treasury and to the state railways sums exceeding half the impayments. In certain quarters this move was censured as inflationary or at least as preventing the deflation necessary to provide price-differentials to accomplish transfer in real goods.⁴ The official Hungarian attitude, warmly supported by the banks and economists, was that the very desideratum in the administration of the fund was avoidance of deflation.⁵ The matter turns in principle simply upon the degree to which it is politically and

1 On February 26, 1935 the designation of the Fund was changed to "Cash Office of Foreign Credits."

2 Tyler, Twenty-third Quarterly Report (July 15, 1937), p. 15.

3 Cf. p. 372 below.

4 Ö I f K., Vol. 6, No. 2, p. 39 ff., and Vol. 7, No. 6, cf. also Machlup in the Neues Wiener Tagblatt, January 1, 1933.

5 U I f W., Vol. 14, p. 116. Cf. also Stephan Varga, "Bemerkungen zu den Problemen von Aufbringung und Transfer," Economic Essays in Honour of Gustav Cassel (London, 1933), p. 654-658.

economically possible to reduce standards of living by the deflationary method of inducing actual transfer. In the actual course of events the maximum outstanding loan of 57,000,000 pengo in June, 1936, does not seem particularly alarming in comparison with a monetary circulation of 598,000,000 pengo, though it admittedly contributed something to the upward divergence of Hungarian from gold-bloc prices.

In dealing with short-term foreign debts the maintenance of good relations with foreign bankers induced the Hungarian authorities to resort to attempts at agreement rather than to unilateral action. Of 1,838,000,000 pengo in this debt category, only 823,000,000 pengo could be covered by agreements, partly because the foreign creditors were scattered and not represented in any organized fashion. Even upon the Standstill debts three months elapsed between the end of the first on August 1, 1932, and the acceptance of the second agreement, and a month again elapsed between the Second and the Third Standstills. The latter, entered upon in March, 1933, was significant in its provision for a 5 per cent annual amortization quota, if the creditor agreed to pengo payment. Although the Third Standstill was expected to run for one year, it was substantially modified on October 20 by the famous Pengo Transfer Agreement.¹ The possible employment of blocked pengo under earlier arrangements had largely been restricted to domestic applications — to granting mortgage loans, purchasing Hungarian shares, mortgages and bonds, acquiring real estate and land, and granting pengo credit to banks.² Under the "Berkovitz Plan" of October 19, 1932, a limited extension of blocked pengo to "additional exports" at a discount from par value was introduced. The Pengo Transfer Agreement now regularized this practice by allowing additional exports against the 5 per cent capital amortization quota, and in addition against voluntary repayments by industries (not banks), provided there was no discrimination between foreign creditors, and finally against other pengo balances approved by the Bank.³ License for additional export required that 20 per cent of the export value be paid in free devisen.

1 Sometimes called the "Martins Agreement," because of the use of Martins Bank, London, as the clearing bank for blocked pengo balances.

2 Hungarian National Bank, special publication, Administration of the Foreign Exchange Control in Hungary (Budapest, June 13, 1933), p. 17.

3 Tyler, Eighth Quarterly Report (November 8, 1933), p. 12.

The Standstill Agreement was renewed for one year on April 4, 1934, with the possibility of one-half per cent interest reductions (to $\frac{1}{8}$ per cent) for prompt payment. The principle of equal treatment of all creditors, originally applied to voluntary payments but considerably modified in the Pengo Transfer Agreement, was now removed altogether. After a temporary extension for three months on April 1, 1935, the Standstill was renewed for a seventh time on June 25, 1935, for one year beginning July 15, with another interest reduction of one-half per cent and a shortening of the compulsory amortization quota to 3 per cent, and this quota persisted until the thorough revision of Hungary's entire foreign debt service in the summer of 1937. When the Standstill was again renewed on July 6, 1936, it included, beside the British and American short-term banking creditors, also the Swiss, French and Dutch. Obligatory capital repayment for state and municipal obligations was raised from one per cent to three per cent prevalent for other Standstill debts, claims for repayments in pengo were made transferable between parties included in the Standstill, and finally pengo balances were made applicable to shares traded on the Budapest Stock Exchange, though such shares had to remain blocked for three years. The Standstill Agreement of 1937 marked a new epoch in Hungarian exchange control by providing for the first time that payments should be made entirely in free exchange. From its inauguration on July 15 this arrangement has, except for certain categories, paid $4\frac{1}{4}$ per cent interest and one per cent amortization.

Under the general prohibition of outward capital transfers under the devisen decrees, payments of Hungarian debtors on foreign debts were sequestered into certain blocked accounts. Various exigencies caused the reclassification of these accounts from time to time, but their composition in 1937 can be taken as representative. There were then eight varieties, four of them genuinely blocked, two merely transition accounts, and two in effect free.¹ The most important category embraced "Blocked

1. The accumulated balances of the various blocked accounts have never been revealed. The description of the accounts given in the text is based chiefly upon the following sources: Administration of the Foreign Exchange Control in Hungary, pp. 13-15, *Devisenbewirtschaftung in Ungarn*, 8th ed. (Budapest, April 20, 1937), pp. 4-8, 9th ed. (Budapest, December 20, 1937), pp. 4-8. Josef Judik, "Devisenbewirtschaftung in Ungarn," *Ung. Wirt. Jrh.*, Vol. 8, pp. 319-320, *Osterreichischer Volkswirt*, April 23, 1932.

Inland Pengo Accounts," held like all other regulated accounts in specified devi-en banks by private and corporate debtors in Hungary. Into these particular accounts were paid interest and redemptions falling under the Moratorium by the Foreign Creditors' Fund of the National Bank.¹ In-payments required permission of the Hungarian National Bank, as also the utilization (possible only within Hungary) of the funds by foreigners. A second category, "Inland Pengo Accounts," included some funds tied up from the bank holidays of 1931, payments on non-mercantile liabilities arising after January 31, 1932, but not covered by the Standstill, and some merchandise debt payments prior to that date. "Inland Merchandise Pengo Accounts" embraced payments only upon merchandise debts originating after January 31, 1932. In- and out-payments were subject to the same provisions as "Blocked Inland Pengo Accounts." But whereas "Inland Pengo Accounts" could not be utilized by foreigners for Hungarian exports, "Inland Merchandise Pengo Accounts" could be by special permission. Finally there were "Old Bill-of-Exchange Accounts" which arose from the deposit of foreign exchange before July 17, 1931, and which like the other blocked deposits required permission for their use.

The Standstill Agreement required that the private person in Hungary should not repay an existing merchandise debt until he elsewhere obtained a new merchandise credit of equal magnitude to supplant it. Pending the presentation of documentary proof regarding the new credit, payments on existing merchandise credits were made according to certain technical determinants into either "Blocked Bill-of-Exchange Accounts" or "Suspense Accounts"; after approval of the new credit, the sums were transferred to the "Blocked Inland Pengo Accounts" mentioned above. "Suspense Accounts" also received in-payments by Hungarian importers during the 6-8 weeks delay after application until permission to pay the foreign seller had been granted by the Bank.

Finally there were two accounts arising from deposits made by foreigners subsequently to July 17, 1931, for which in- and out-payments required no permission of the Hungarian National Bank, and for which the Bank upon petition made payment in genuine

¹ These accounts include also the service on certain old and new merchandise debts on certain old non-mercantile liabilities outside the Standstill, and deposits made by foreigners of pengo bank notes.

foreign exchange. These deposits were called "Free Foreign Pengo Accounts" and "Free Foreign Exchange Accounts," the difference being that with the former the foreign depositor accepted a pengo equivalent of his surrendered *valuta*, whereas with the latter he maintained the account in terms of some specific foreign currency. Neither of these varieties belongs to the category of genuine blocked accounts.

Amongst the various types of blocked accounts only four, as we have seen, represented genuine blocking, and of these only two, resulting from the Moratorium and the Standstill, were sufficiently traded in to be quoted continuously on the chief international markets. The curve of quotations on Standstill pengo (Fig. 13, p. 94) as a percentage of parity shows that, once the value of these pengo had assumed an absolute magnitude given by foreign evaluations in view of permitted uses at about 50 per cent of par, their general course paralleled quite closely the Zurich quotations upon pengo notes, which in turn, according to previous analysis,¹ can be explained in terms of monetary policy and the behavior of prices in Hungary.

Two major exceptions to this parallel movement are the high level of Sperrpengo values from September, 1933, to July, 1934, in the teeth of a decline in pengo note quotations, and the disproportionate rise of Speerpengo relatively to notes from March to July, 1937. The first of these departures rested upon an exception made by the Hungarian National Bank to its general rule restricting Sperrpengo to industrial exports and permitting temporarily the purchase of farm products as "additional exports" to further the marketing of the large crops of 1933.² When the Bank returned to its regular practice Speerpengo dropped rapidly in the latter half of 1934 from 58.3 per cent to 44.4 per cent. This movement re-established the parallel with pengo notes, which declined from 75 per cent to 66 per cent meanwhile, and with the inverse movement of the price of gold on the Budapest market (Fig. 13, p. 94). Seasonal advances in the value of Speerpengo can also be observed in the fourth quarter of 1935 and the third quarter of 1936, indicating presumably that for a short period the Bank permitted the use

1 Cf. pp. 93-106 above.

2 Eugen Róz, "Das dritte Jahr der Devisenbewirtschaftung," *Ung Wirt Jhrb.*, Vol. 10, p. 243 ff.

THE PRICES OF HUNGARIAN COUPONS (1) AND STANDSTILL PENGOS (2) IN ZURICH* AS
PERCENTAGES OF PARTY†

	1932	1933	1934	1935	1936	1937	1938	1939
January	1	1	2	1	2	1	2	1
February	52.2	72.2	56.1	47.7	36.6	45.0	29.1	40.2
March	55.5	71.6	56.6	47.7	28.9	42.2	26.4	40.0
April	47.7	71.0	55.5	47.5	27.8	42.2	25.2	43.1
May	51.1	71.0	56.1	47.5	38.3	42.2	26.0	45.4
June	53.3	71.6	54.4	29.4	46.9	27.2	42.5	24.8
July	72.2	64.4	70.5	58.3	30.5	46.9	29.4	54.3
August	72.2	67.7	52.7	60.5	56.1	29.4	46.6	31.1
September	78.3	68.8	52.2	61.1	54.4	29.1	46.3	45.4
October	81.0	72.2	53.3	57.2	52.7	33.0	46.3	30.5
November	81.0	73.3	54.4	59.4	47.7	33.0	48.3	30.7
December	68.3	74.4	57.2	58.3	45.5	36.1	48.0	30.3
	61.1	73.8	56.1	55.6	44.4	35.5	48.0	29.9

*Except for 1938 and 1939, for which quotations pertain to the Budapest market.

†The original data are Swiss francs per 100 pengo. For those data through 1937, but excluding 1935, I am indebted to the Chase National Bank, New York, for the data for 1935, 1936, and 1939. I have to thank Dr William Fellner, formerly of the Hungarian Institute for Economic Research, now of the University of California. Coupons were not dealt in before June, 1932, nor Standstill pengos before July, 1933, and dealings in the latter were suspended after July, 1937. Missing quotations within these limits are indicated by leaders.

of these blocked accounts for agricultural exports¹ The sudden advance of Standstill pingo from 40 per cent in February, 1937, to 54.3 per cent and 55.9 per cent in May and July rests upon market anticipations of the favorable debt settlement After this settlement in July the National Bank became the sole purchaser of Standstill pingo, market quotations disappeared, but there existed a continuous offer by the Bank at about 47 per cent, representing a mean of prices for two and one-half years previously

Quotations on Hungarian coupons, or interest obligations under the Moratorium, have tended irregularly downward as the prospects of maintenance of contractual interest have gradually become extinct, and as the field of utilization has, with occasional reversals, been narrowed down Thus the recovery from 48 per cent to 75 per cent from March to November, 1933, is definitely linked with the development of regular trading in coupons for purposes of travel in Hungary by other persons than the original coupon-holders² The violent fall from 56 per cent to 29 per cent between December, 1934, and May, 1935, was precipitated by an ordinance of February 24, 1935, reducing the possibility of illegal repatriations From May, 1935, throughout the balance of the year, there appears to have been something of a recovery in this business, lying at the bottom of the advance of coupon quotations to 30 per cent, but the final categoric prohibition of security repatriations in January, 1936, again ushered in declining coupon prices³ The debt settlement of July, 1937, apparently reduced yields below what had been expected and caused a shading off in coupon prices, but the really disastrous plunge came in March, 1938, with the German seizure of Austria and foreign misgivings concerning the fate of Hungary The revival of coupon prices during the early months of 1939 was probably a by-product of the large amount of funds poured into Hungary from Germany via the Zurich market preceding the Hungarian general elections in May⁴

Save for the very limited cases of payment in free exchange which have already been noted, service upon Hungarian foreign debts prior to July, 1937, proceeded through payments "in kind," i.e. through creditors' acquisition of goods and titles or the utiliza-

1 Devisenarchiv, Vol 1 (August 25, 1936), p 921

2 Cf Róz, loc cit

3 Die Stunde (Vienna), January 23, 1936

4 New York Times, May 21, 1939, p 18

tion of services in Hungary, or through "additional exports" The last possibility rested upon a readiness of foreign creditors to accept quantities of Hungarian exports even at the artificially high price given by the application of the official rate of exchange, in order to realize immediately upon their claims This concession was transferred to the Hungarian exporter through his being given permission by the National Bank to receive from foreign creditors the blocked pingo (at par) and to sell such pingo at an "additional export premium" paid by the Bank in domestic pingo Hungary was indeed the first country to exploit creditor concessions as a means of liquidating debts cheaply and at the same time sustaining exports and employment The rate at which debt service was maintained through this device depended, it was said, upon the export being one "of which the foreign-exchange proceeds are not required for the maintenance of Hungary's economic life"¹ Since this criterion came to be recognized in the course of time as rather too abstract and vague for particular cases, additional exports were subsequently defined quite simply as those for which the National Bank "pays a premium exceeding the ordinary amount"²

Under the First Standstill (March 31, 1932) foreign creditors were limited in the utilization of blocked accounts to investments of various categories within Hungary But the Berkovitz Plan

EXPORT AGAINST PENGÓ HALF YEAR TOTALS*

In Millions

1932	I	2 9	1936	I	6 2
	II	1 6		II	10 6
1933	I	7 6	1937	I	13 4
	II	27 9		II	7 7
1934	I	20 4	1938	I	4 4
	II	14 9			—
1935	I	9 8		Total	135 6
	II	8 2			

*Ung Wirt Jhrb, Vol 14, p 363

(October 19, 1932) opened up the possibility of realization through exports, a decree of April 8, 1933, permitted application of Standstill balances to the travel of third parties, and finally the Pengó

1 Text of the Pengó Transfer Agreement (October 20, 1933), p 3 as distributed in mimeographed form

2 Devisenbewirtschaftung in Ungarn, 9th ed (Budapest, 1938), p 44

Transfer Agreement (October 20, 1933) extended and regularized additional exports. Ostensibly because the demand for Hungarian industrial products was "inelastic,"¹ permission for additional exports was only exceptionally given for agricultural products — chiefly in the crop-moving periods of 1933–34 and 1936–37,² as the figures on page 152 show.

The extent of export premia is not known. The nominal rate appears to have been rather regularly between 105 per cent and 110 per cent,³ but varying portions of the export devisen had to be surrendered by the Hungarian seller at the *regular* export premia — for example, latterly at 50 per cent to free devisen countries — and since these proportions have not been allowed to become public, the effective "additional export" premium rates cannot be determined. The volume of exports in this category has been estimated reliably for 1933–1936 at 6,000,000 pengo, 24,000,000 pengo, 32,000,000 pengo, and 34,000,000 pengo, and somewhat less reliably for 1937 at 60,000,000 pengo.⁴ Since these sums include premia on an unknown fraction of the total, it is impossible to know how much of the Standstill debts was liquidated in this way. Responsible Hungarian commentators have complained that the high "additional exports" premia encouraged mushroom industries in Hungary, called into being for the very purpose of producing "additional" exports, furthermore, the Hungarian exporter was often tempted to share his profits to induce the foreigner to absorb more of these exports. The process resembles exchange dumping and tends to depress the pengo on foreign markets. In the debt settlement of 1937 additional exports were contemplated as an important mode of carrying forward the service upon Standstill debts.⁵ It was left to the Hungarian National Bank to determine the extent of transfer which could be thus maintained without disaster to the domestic economy.

1 According to the verbal report of a high banking official in Budapest.

2 Cf pp 136, 138 above.

3 Devisenbewirtschaftung in Ungarn, loc cit., Neue Freie Presse, October 9, 1935.

4 For 1933 and 1934, Josef Judik in Villaggazdasdie Szemle, February 4, 1935, for 1935 and 1936, Ungarns Handel und Industrie im Jahre 1936 (Budapest, 1936), p 22, for 1937, The Royal Institute of International Affairs, South-Eastern Europe, p 120. The last estimate seems impossibly large, since the entire debt service after the agreements of 1937 was estimated at 45–50,000,000 pengo.

5 Economist, September 18, 1937, p 565.

The premia now approximate the general level paid for exchange on free devisen countries at about 50 per cent¹

A new epoch in Hungarian economic history since the credit crisis of 1931 was heralded in June, 1937, by the first offer of terms upon which the Hungarian authorities stood ready to resume effective transfer on the debt service in free devisen. Culminating in this event were three favorable circumstances: the simplification of premia and surcharges in 1935, the improvement in terms of trade for Hungary through the rise of agricultural prices, and the large harvests of 1936. The proposals for a settlement made by Fábinyi and Imrédy on behalf of Hungary were favorably reported upon to their constituencies by the League Loan Committee, the Council of Foreign Bondholders and the American Protective Association. Excluding commercial debts, which required no negotiation, and the *Caisse Commune* obligations, which Hungary inherited from the old monarchy, the outstanding foreign indebtedness at mid-summer 1937 was 1,750 000,000 pengo divided as follows:

Long-term Debt		Short-term Debt	
State	379,000,000 Pengo	State	219,000,000 Pengo
Others	490,000,000 Pengo	Standstill and similar	246,000,000 Pengo
		Pre-exchange-control	170,000,000 Pengo
		Exchange control	246,000,000 Pengo
Total	869,000,000 Pengo	Total	881,000,000 Pengo ²

By the close of 1937, 1,238,000,000 pengo of this total of 1,750,000,000 pengo had been arranged for or virtually so, and by the close of 1938, after amortization of 20,000,000 pengo, the settlement of nearly the entire 1,750,000,000 pengo foreign debt could be announced.³ This signified, in the opinion of one of the Hungarian National Bank directors, that recovery from the worst effects of the world financial crisis had largely been achieved.⁴ Payment in blocked accounts ceased.

The full contractual debt service prior to the settlement

1 Pester Lloyd, May 15, 1937

2 Josef Judk, "Die ungarische Devisenbewirtschaftung und die Neueregelung des Auslandsschuldendienstes," *Ung Wirt Jhrb*, Vol 13, pp 306-319. The Royal Institute of Economic Affairs, South-Eastern Europe, pp 121-122, gives the total at 1,838,000,000 pengo without disclosing the source of the figure.

3 Tyler, Twenty-fifth Quarterly Report (February 26, 1938), p 13, and *Volkswirtschaft* 1938, pp 251-252.

4 *Ung Wirt Jhrb*, Vol 14, p 365

would have involved on long-term account 90,000,000 pengo and 30,000,000 pengo in interest and amortization, and on short-term account 30,000,000 pengo and 30,000,000 pengo. By the terms of the settlement this contractual total of 120,000,000 pengo was reduced to 50,000,000 pengo annually, an increase of about 10 per cent over the actual accomplishment under various devices of exchange control during the preceding two or three years.¹ Interest from 1½ per cent to 1¾ per cent was agreed upon with long-term creditors, while Standstill creditors received one per cent in interest and 4¼-4½ per cent amortization annually.

What had been accomplished during the six years since the introduction of exchange control by Hungary toward the liquidation of her foreign debts? The most authoritative statement emanates from Dr Josef Judik, former Director of the Economic Division and at present a Director of the Hungarian National Bank of the 4,310,000,000 pengo indebtedness at the close of 1931, 2,500,000,000 pengo remained in July, 1937, of this difference of 1,810,000,000 pengo, about 32 per cent (1,376,000,000 pengo) had disappeared simply as a result of foreign devaluations, and 350,000,000 pengo represented illegal capital repayments through security repatriations.² According to Dr Judik's own estimates, only 70,000,000 pengo would remain as the "substantial amount" of regular amortization to which he refers. The League of Nations report of balances of payments, however, gives the following

CAPITAL ITEMS IN THE HUNGARIAN BALANCE OF PAYMENTS⁺

(+Inward, -Outward, in Million Pengo)

	Long Term	Medium and Short Term	Total
1932	+14	+52	+66
1933	+2	+3	+5
1934	+0	-160	-160
1935	+16	-490	-480
1936	-17	-559	-576

*League of Nations, Balances of Payments 1937 (Geneva, 1938), p 117

1 Volkswirtschaft 1938, loc cit

2 In a statement before the Hungarian Parliament Dr Greosak estimated debt reductions by devaluation and bond repatriation at half the original sum,— i.e. at somewhat over 2,000,000,000 pengo in comparison with Judik's 1,726,000,000 pengo. Cf Neue Zurich Zeitung, June 9, 1937. After the dollar and pound but before the gold block devaluations, Kemeny writing in the Österreichischer Volkswirt of February 23, 1935 (pp 346-347) estimated the devaluation gains at 1,100,000,000 pengo and repatriations at (par values) of 300-350,000,000 pengo — together 1,450,000,000 pengo

Over the five years 1932–1936 the League statistics show net total repayments of 114,800,000 pengo Subsequent balances are not available, but there is every reason to suppose that to July, 1937, repayments proceeded at no less a rate than in 1936 If so, we would have something like 140,000,000 pengo amortization since 1931, or twice the amount got residually from Dr Judik's estimates But the difference is, after all, merely between 12 per cent and 24 per cent, representing the share of debt reduction during the period 1932–1936 by means of all devices, including devisen payments and additional exports, carried through legally under the exchange control apparatus¹ Of course it is not to be forgotten that net outward interest payments of a magnitude about equal to amortization were also transferred²

In retrospect it appears that the transfer of debt service went forward upon a very modest scale, but even spokesmen of the creditor countries pointed out that the effective interest rates should be judged in view of money rates in the creditor countries themselves during the depression³ Fully a fifth of the State debt and nearly a third of the private long-term debt was contracted at 7½ per cent, and in the latter category rates up to 14 per cent were not unknown⁴ The incubus which such rates would have imposed on the whole economy warranted the conclusion reached by the Economist as early as October, 1933, that the one-sided regulations of the Hungarian authorities in the end benefited not only the distressed debtors but also foreign creditors⁵ Two further factors assume great significance — the terms of trade and the portion of Hungarian favorable balances available for debt service In an earlier connection we saw how by 1933 Hungarian export prices in terms of import prices had reached 82 per cent of their 1925–27 level⁶ Had trade proceeded at 1928–29 prices in 1938, imports would have been 68 per cent and exports 126 per cent of their 1928–29 values, and the favorable balance would have been 400,000,000 pengo instead of 113,100,000 pengo⁶ But of the

1 The League's figure (*loc. cit.*) for the five years is 121,400,000 pengo, to which I have added for the first half of 1937 12,600,000 pengo, giving a total of 134,000,000 pengo

2 Economist, December 7, 1935, p 1125–1126

3 Magyar Statisztikai Szemle, Vol 10, p 1932

4 Economist, October 28, 1933, pp 815–816

5 Cf p 130 above

6 Ung Wirt Jhrb., Vol 14, p 188

favorable balance not more than 20 per cent brought in free devisen¹ The reasons for resort to the additional export device and its continuance since the 1937 debt settlement are thus not far to seek

A comparison unfavorable to the genuineness of Hungary's efforts to maintain the debt service might be made between the approximate 140,000,000 pengo of transfer carried on through official channels to July, 1937, and the 350,000,000 pengo of repatriations of Hungarian bonds illegal repayments amounted to two and one-half times as much as legal repayments One might legitimately enquire whether repatriations did not bespeak a much greater capacity to repay than the actual accomplishment, and whether the former did not assume its great magnitude simply because it was profitable, whereas the latter remained small simply because delay, bringing with it devaluations and creditor concessions, was also the profitable course There would be nothing implausible in ascribing to Hungarian debtors motives of a sort which the creditors might also have discovered in themselves A somewhat more reasonable apology for the situation, however, lies in the practical obstacles to carrying though refunding agreements upon the manifold issues of industrial bonds, each with its scattered group of owners, and in the absolute necessity for industrial and government units to reduce the dead hand of interest in a depression of unparalleled severity

THE TECHNICAL EFFICIENCY OF HUNGARIAN EXCHANGE CONTROL

The Hungarian control system has been subject to illegal and legal evasions similar to those practiced in Germany and Austria — outright smuggling, circumvention by various technicalities, juggling of blocked pengo accounts to apply the funds to prohibited uses, and false bills of lading The last practice was ubiquitous and particularly interfered with the functioning of clearings As officials in the exchange authority have pointed out, a decline in the actual pengo rate, instead of stimulating exports and improving the Hungarian balance, increased the motive for Hungarians to undervalue their goods in bills of lading for export over the fixed parity clearings, with the result that this force at least operated toward a progressive worsening of the balance of trade

1 Cf p 121 above

Hungarian exchange control was peculiarly subject to evasion through the repatriation of securities. In diametrical contrast with Germany, where repatriation was managed by the Gold- und Diskontbank as the one important source of export subsidy as long as the foreign supply lasted, Hungary prohibited but did not succeed in suppressing the private acquisition of domestic securities from foreign holders. Prior to the first measure directed against the practice in October, 1932, the business flourished upon the enormous differentials between domestic and foreign quotations, often amounting to from 66 per cent to 75 per cent.¹ Funds for these purchases had to be got abroad by illegal ways — by direct smuggling of currency, by leaving the proceeds of exports on deposit abroad, and by concealing ownership of foreign balances. Hungarian corporations could buy up their own securities at bargain rates, despite high prices for "bootlegged" foreign currencies and high payments for the services of smugglers. Occasionally payment was made in newly issued bonds, but frequently the corporations simply pocketed the proceeds as profits and covered the shrinkage of capitalization by drawing upon commercial banks for loans. Ultimately the central bank was thus brought into the position of financing a fair share of the operations violating its own exchange-control regulations.

The original Moratorium decree of December 22, 1931, required that matured obligations and coupons should be paid into the Foreign Creditors' Fund, an administrative rule provided that out-payments should be made into free pengo accounts only when the bonds belonged to Hungarian nationals. Abuse of this ruling by the purchase of bonds belonging to foreigners led to a decree on October 31, 1932, that when application was made for redemption into free pengo accounts the bond should be deposited for eight days to permit the National Bank to establish its ownership by a Hungarian. Evidently the enforcement of this ruling was ineffective, for on February 24, 1935, substantially the same ordinance was repeated, this time complemented with the requirement of central bank permission for each security transaction with foreigners.² The sudden decline of Hungarian coupons on the Zurich market between December and May from 56 per cent

1 Kemeny, *Oesterreichischer Volkswirt*, December 24, 1932, p. 312.

2 Tyler, *Eighteenth Quarterly Report* (April 18, 1936), p. 12, U. I. f. W., Vol. 26, p. 130.

to 29 per cent of parity¹ shows that the measure was effective, especially in conjunction with the simultaneous abolition of the Budapest free gold market.² Finally, on January 22, 1936, the importation of Hungarian bonds was categorically prohibited, the proceeds of coupons could be paid to free pengo accounts only if the bond were deposited with the National Bank.³ With the exception of a short period two years later, repatriations virtually disappeared.⁴ A sporadic recurrence of the practice attended the debt settlement of 1937 and the development of an inland demand for non-State foreign bonds, but the evasions were quickly suppressed.⁵

Repatriation undoubtedly constituted the most serious lacuna in Hungarian exchange control. Statistical apprehension of its magnitude is of course as difficult as legal apprehension of the practice. For 1932 estimates put repatriation as low as 40–50,000,000 pengo⁶ and as high as 100–150,000,000 pengo.⁷ By the end of 1934 the cumulative total was estimated at 300–350,000,000 pengo⁸ and by the time of the 1937 debt settlement at 520,000,000 pengo in original values or 350,000,000 pengo in depreciated foreign currencies.⁹ This magnitude, almost equalling the total favorable trade balances from the half-year 1931 to the half-year 1937 and exceeding estimated regular amortizations during the same period by 250 per cent,¹⁰ exercised a strong downward pressure on the foreign value of pengo. Even a doctrinaire opponent of state intervention could take no satisfaction from this breakdown of exchange control. The inferior position of the foreign creditor resulting from the Moratorium was exploited, not to public but to private advantage, and the adverse turn to Hungarian terms of trade entailed the very costs which exchange control was designed to avoid. The continuance of large repatriations through four

1 Cf coupon quotations on p 137

2 Cf pp 147–148 below

3 Cf Tyler, loc cit

4 Tyler, Twenty-first Quarterly Report (January 16, 1937), p 9, *Ungarns Handel und Industrie im Jahre 1936* (Budapest, 1937), p 47

5 Tyler, Twenty-third Quarterly Report (July 15, 1937), p 12

6 Georg Kemeny, *Pester Lloyd*, January 6, 1933, p 13

7 Economist, February 25, 1933, p 409

8 Georg Kemény, *Osterreichischer Volkswirt*, Vol 27, p 347

9 Judik, cf p 155

10 Cf p 144

years of exchange control bespeaks a lack of administrative effectiveness or a sinister yielding to particular interests

Evasion in the form of repatriation was undoubtedly facilitated by the existence of a free market for gold in Budapest. Although the export of precious metals came under the general embargo of exchange control, arbitraging operations, known at times to have involved thousands of bonds at a single deal, were made easy through this method of acquiring "stable" values.¹ The general impression seems to be that the gold market was tolerated as a sort of safety valve for liquidity preferences and demand for a non-depreciating asset, perhaps also as a necessary adjunct to the profitable business of repatriation.

During most of its history, especially during the persistent rise of the price of gold in 1934, various Hungarian commentators characterized the Budapest gold market as "artificial," "narrow and speculative," "not significant for exports"—in short an altogether fallible index of the value of pengo.² Nevertheless, several other indices told about the same story. Until the devaluation of the dollar, black market quotations on American exchange indicated approximately the same amount of pengo depreciation as did the price of gold.³ The securities market is said to have followed gold prices rather closely (Cf Fig 13, p 94). Finally, as has already been explained in some detail, the price of pengo notes in Zurich varied inversely to the Budapest gold price with considerable regularity, and the price of Standstill pengo⁴ took a course similar to that of pengo notes, although at a lower absolute level. The agios on free exchange countries announced at the close of 1935 as a part of the rate unification coincided with current quotations of gold. Shortly afterward, in March, 1935, the gold

1 Oesterreichischer Volkswirt, Vol 27, p 145

2 These opinions were expressed verbally by numbers of persons in official positions

3 The following quotations from the black market for dollars are derived from Tyler, Quarterly Reports

Date	Pengő per Dollar on the Black Market	Premia on Dollars	Premia on Gold on the Gold Market
December 31, 1931	8 3-8 5	47	70
January 12, 1932	7 7	40	47
March 30, 1932	8 1	42	37
April 30, 1932	7 8	40	37
July 15, 1932	7 7	39	37
October 27, 1932	7 3	28	26

4 Cf p 137, below

market was suppressed, though the virtual devaluation involved in the new agios would have rendered its persistence nearly innocuous

How much the evasions of exchange control in Hungary amounted to in the aggregate is a matter of guesswork. Statistics of devisen receipts and disbursements by the National Bank and their expression as percentages of exports and imports published regularly in the Quarterly Reports of the League of Nations representative in Austria have practically no significance, despite their perennial reproduction in the Reports of the Hungarian Institute for Economic Research, the London Economist and in the daily press. The percentages give no index of the exhaustiveness of the Bank's control over devisen, the main cause of divergence between exports and devisen received in any given quarter being the time lags between notification of export, actual export, and receipt of payment. Over a long period of time, however, these lags assume relatively small significance. Total devisen expenditures over the period 1932 to 1937 expressed as a percentage of total imports is 101.1 per cent, total devisen receipts expressed as a percentage of total exports is 89.7 per cent.¹ Since expenditure of devisen usually follows importation, the former percentage exceeds 100 per cent only because of lack of consistency in the modes of reporting devisen and imports, the latter percentage would not be much increased by the liquidation of payments receivable, since these are short-term accounts and the totals embraced six whole years' trade.

Something like nine-tenths, therefore, of export proceeds as recorded have been apprehended by the bank. Evasions by false bills of lading, smuggling, importations not really made, etc. fail to be revealed in such figures. One harassed official of the Hungarian Bank declared that evasions would eventually put an end to exchange control, another official of the same Bank thought the Hungarian control fairly effective, but explained that devisen escaping the Bank's control were precisely the "marginal increment" necessary for the debt service. Devisen outlays for rearmament were evidently not considered marginal, the foreign creditor automatically shouldered much of the burden of the lack of efficiency of the exchange control.

¹ Devisen receipts and disbursements by half-years are summarized in *Ung Wirt Jhrb.*, Vol. 14, pp. 363-364.

CONCLUSION

A brief retrospect over the analysis of Hungarian exchange control may serve to bring the chief areas of economic light and shadow into sharper definition. Like other heavily indebted European states in 1931, Hungary found exchange control to be a virtual necessity in coping with a flight of capital, since the reduction of prices and wages was precluded as a political impossibility. The automatic process by which exchange control through mere temporizing gradually passed from an emergency measure to an integral part of the national economy is officially defended as a necessary consequence of a state of perpetual crisis in international financial and monetary affairs extending to the present. But these external difficulties were no less real for Austria, where exchange control was slowly reduced to a control over capital repayments and to clearing with exchange-control countries. Hungary accepted a totalitarian philosophy in economic matters and, probably without much deliberate choice, retained exchange control as an already established instrument of protectionism and *étatisme*.

Whatever were the measures taken toward simplifying the control system or extending the field of freedom in payments, they were, as we have observed, generally welcomed as economic gains by the business community with the exception of the cartels. Three changes of significance in this direction were (1) departures from the official pengo parity beginning late in 1932, (2) abandonment, late in 1935, of differential exchange rates as between countries and commodities in favor of a simpler scheme of linear premia surcharges, (3) resumption of devisen payments on foreign debts in the summer of 1937. The very fact that, aside from some increases in stringency from the angle of purely technical administration, the changes in exchange control reduced its extent or its intensity judged from a norm of free exchange, may fairly be taken as evidence that the authorities themselves, however much they protested loyalty to the principle, nevertheless found exchange control to be an onerous system.

The mitigations did not prevent the inclusion of something like 80 per cent of Hungarian foreign trade under clearing, compensation, and sales and purchases against pengo—none of them yielding freely disposable bills of exchange, nor did they prevent artificiality in exchange rates, despite the (rather incomplete)

recognition of pengo depreciation through the official agios on devisen, nor finally did they dispense with the non-price allocation of import devisen through authoritarian allocation and the certificate system. The essential characteristics of exchange control persisted. What consequences have we been able to unearth as pertaining specifically to exchange control in the welter of regulation extending from import and export quotas, prohibitions, licenses, to tariff protection?

An examination of the economic history of Hungary over the period 1931-1939 shows that exchange control was surely secondary to the influence of world depression and recovery. So far as concerns the external value of the pengo, as measured by Budapest gold premia, the price of pengo notes in Zurich, dollar premia and finally by the official agios on foreign exchanges, the larger movements can be explained in ordinary equation-of-exchange terms such as domestic production and monetary policy relatively to similar forces abroad. In the long run exchange control had no greater influence on the value of the monetary standard than the reduction of further pengo depreciation through further capital flights. In the domestic scene exchange control, through penalizing exports and subsidizing imports, increased the discrepancy between agricultural and industrial prices. Whether the state aids to agriculture even offset the burden imposed by exchange control seems very doubtful. Furthermore, the premium system on grain exports, by its artificial support of the pengo rate, made impossible any clear view as to the economic profitability even of "non-subsidized" exports.

Despite the authoritarian regime of exchange control, Hungarian foreign trade still shows the dominant force to be cyclical variations in western Europe and America. But secular developments fall under the sway of autarkic devices, amongst them exchange control. The percentage of total imports embraced under finished industrial products fell from 55 per cent in 1928 to 35 per cent in 1938. Although world agricultural prices rose relatively from 1935 to 1938, Hungarian foreign trade, which had declined more than the world average, failed to keep abreast of world recovery. It was notably in 1933 and in 1936, after the two major changes in exchange control toward recognition of pengo depreciation and simplification of rates, that foreign trade experienced

its largest single advances, but the conclusiveness of this evidence is decreased by abundant harvests just at these junctures

Drastic changes in direction of foreign trade inexplicable upon the basis of international division of labor attended the exchange control regime. The steady increase of the share of both exports and imports carried on under clearing and compensation over the years 1931–1936 (from 67 per cent to 76 per cent, and from 75 per cent to 86 per cent, respectively) is not in itself tantamount to a dislocation of trade by countries, but rather by modes of payment. Had the clearing and compensation method not increased, however, it would not have been possible that Italy and Germany should have so greatly expanded their shares in Hungarian trade. The fundamental cause or prime mover of changes in direction of trade was not exchange control, but it implemented the real factor, an international political re-alignment. The sharp turn of Hungarian exports toward England and Switzerland in 1931 was a reflection of a flight of capital before exchange control became really effective. In this respect the control had a negative or preventive operation against changes in direction of trade, and the ossifying of trade channels under exchange control against free economic forces must not be neglected merely because it fails to strike attention in trade statistics.

In two aspects of international economic relations the effect of exchange control was unmistakable. Both from the basis of *a priori* expectation and from striking individual instances, it appears that the presence of clearings tended to raise prices of imports into a clearing country and the prices it obtains from exports to a clearing partner, both cases being taken relatively to imports from and exports to free-exchange countries. The terms of trade between clearing countries may turn either way, but are deteriorated relatively to free-exchange countries. Hungary's greatest loss in terms of trade came from the agricultural depression, but the export penalty involved in the par pengo or in insufficient agios on free devisen accentuated the loss. Finally we have found exchange control clearly operative in one of its primary purposes — the prevention of capital flight. Even if illegal repatriations at two and one-half times the magnitude of permitted transfers are counted in the total, the repayment of something like five per cent on capital account over the period 1932–37 would be only a fraction of the outward flow of capital, had it been

freely permitted. But if the same facts are viewed from the angle of an "orderly liquidation" of foreign obligations under authoritarian auspices, the record is certainly unimpressive.

Save for the not completely successful obstacles put in the way of capital flight, we have failed to discover a net economic gain which Hungary could legitimately ascribe to exchange control. But by no means uncommon is the contention that, whatever were the asperities and shortcomings of exchange control in Hungary, it succeeded at least in "maintaining the pengo at home at its original legal parity,"¹ in assuring confidence as to the preservation of the monetary standard,² or in actually securing stability in the value of the pengo at home.³ The ostensible aim of exchange control in preserving the real foreign value of the standard is thus admittedly not attained, but *something* was thought to have been accomplished. Just what? Since prices within Hungary responded quite clearly to underlying money and production variables, the only thing actually preserved was the fictitious parity of the pengo, a fiction which did not even pertain to domestic economic matters.

For the preservation of this fiction and for protection to industry given by exchange control, the Hungarian consumer ultimately paid the cost. The fall in agricultural prices was partly offset by multifarious state aids, such as interest abatements, moratoria, and the wheat and rye premia studied in Section B. Industry held a relatively favored position under the shelter afforded by the limited devisen allocation for imports. The system of subvention to agriculture was regressive from the viewpoint of consumer income premia rested upon consumption taxes, and a large part of the proceeds went to landed interests, not to agricultural laborers or small farmers. According to M. Kormendy-Ekes, "Half the country is shared between about 840,000 small holders, one-fifth between 10,000 middle-sized estates."⁴ In industry the successful maintenance of prices prevented any sharing of its relatively favored position by consumers of its products.

1 Devisenarchiv, Vol. 3 (Folge 39, September 27, 1938), p. 486.

2 Pester Lloyd, January 1, 1935, p. 17.

3 According to an unpublished pronouncement of the President of the Royal Hungarian Bureau of Foreign Trade in 1935.

4 "Big Estates in Hungary," Hungarian Quarterly (Spring issue, 1937), quoted in South-Eastern Europe, p. 58.

Even in 1929 wages in Hungary stood at very low absolute levels, factory labor receiving an average hourly wage of 32 filler or 6.4 cents.¹ By 1932 money wages had declined to 84 per cent, by 1933 to 78 per cent, and by 1935 to 77 per cent—a decline in each of these years unparalleled for eighteen countries reported.

COST OF LIVING INDICES FOR HUNGARY*
(1925-27 = 100)

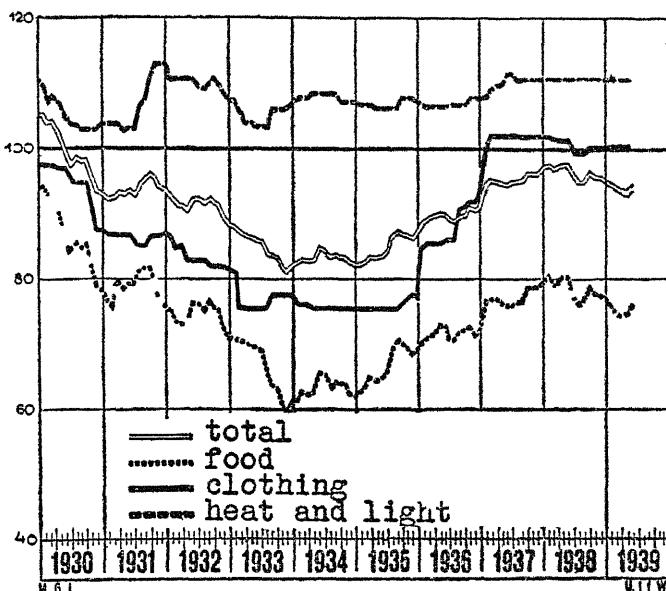


FIG. 18

*U I f K, Vol 41, p 53

by the League.² The decline in agricultural money wages in 1933 to 47 per cent of 1929 similarly exceeded all other countries but one. As shown by Fig. 18, the cost of living declined by the end of 1933 to 80 per cent of its level in 1925-27, or to slightly less than 80 per cent of its level in 1929. As a result real wages for

¹ O I f K, Vol 10, No 11, p 257² League of Nations, World Economic Survey 1934-35 (Geneva, 1935), pp 136-137, ibid., 1936-37 (Geneva, 1937), p 112

labor as a whole declined somewhat, registering a low point of 91 per cent in the first quarter of 1933. Instead of securing something of a compensation for extensive unemployment by a gain in real wages, the "normal" expectation for depression, Hungarian labor actually had to accept a reduction in real wages. For agricultural labor real wages fell to about two-thirds the 1929 level, though employment was probably fairly well maintained.

It is, of course, impossible to assess precisely the responsibility borne by exchange control for this situation. It would be natural to expect an adverse turn in real wages in consequence of the peculiar severity for Hungary of world agricultural depression, which carried national income to 48 per cent of the 1929 figure in 1932, the greatest reduction in national income reported in League statistics.¹ Reference, however, to Fig. 17, p. 108, showing the relative course of fixed and free prices of industrial raw materials, indicates where part of the responsibility lies. Coal, lignite, and firewood show a slight rise after 1930 rather than a reduction in price, and the "heat and light" component of the cost of living index in Fig. 18 behaves in the same way. Exchange control, as we have seen,² contributed in a variety of ways to raise or maintain prices for industrial raw materials such as these fuels and hence to hold up the cost of living.

The cost of living was buttressed, however, from other angles by exchange control. The "food" component (Fig. 18) may seem to have shown as great elasticity as could be expected, falling to 60 per cent by the end of 1933, but because of cartel price-maintenance, protective tariffs, quotas, exchange control, and the artificially high level of grain prices, the reduction in prices of agricultural staples was not passed on in comparable measure to the consumer. Studies made by Professor Heller of the Technical University of Budapest disclose the results upon consumption in the cases of beer, milk, and sugar.³ Between 1928 and 1932 barley fell in price by 50 per cent, but the price of beer was not reduced and beer production slumped from 670 to 231 thousand hectoliters. From January, 1931, to December, 1932, milk consumption in Budapest under rigid milk prices declined from 9.3 to 8.2 million

¹ League of Nations, *World Economic Survey 1935-36* (Geneva, 1936), p. 104.

² Cf. pp. 106-107, above.

³ Tyler, *Seventh Quarterly Report* (August 10, 1933), p. 15.

liters From January, 1931, to April, 1933, sugar consumption fell from an index of 119 (1927 = 100) to 85, the price of sugar in Budapest averaging 102 pengo per kilo, as compared with 50 pengo in London and 40 pengo in New York Since real wages did not increase during the depression years, there is little wonder that the entire period of industrial recovery from 1933 to 1938 failed to show a recovery even to levels reached in early depression years¹ Only in the latter half of 1938 and early in 1939 did the index of real wages, under the "forced draft" applied to production by the Five Year Plan, show advances to 114, 115 and 116 in successive quarters compared with annual averages of 106 and 104 in 1930 and 1931 By this time, however, the severe narrowing of consumer choice through various protectionist measures, together with either spontaneous or prescribed lowering of qualities in fabricated goods, puts the supposed advance in real wages under considerable suspicion

From one viewpoint, the maintenance of the parity pengo and protection from foreign competition through exchange control become two aspects of one thing — the effort to maintain for the country artificially favorable terms of trade To the degree to which parity is *actually* maintained, "protection" and favorable terms are actually secured — admittedly at an economic cost A discussion of free trade versus protection is unnecessary in the present connection, it suffices that the official apology for the Hungarian protective policy rested chiefly upon non-economic grounds, upon the necessity of providing the producer a psychology of security against the hazards arising from the Peace Treaty, international monetary disturbances and political stress² But even from the angle of protection, the artificial pengo rate was a dangerous instrument, for it transferred the granting of protection from the explicit form of tariff schedules to the secret and arbitrary form of administrative decisions in the allocation of import bills, favoring some industries by providing cheap exchange for imported materials and others by limited allocations for imported finished goods The secrecy maintained concerning allocations to particular firms converted exchange control into a formidable weapon of internal politics

To the degree that pengo parity was sacrificed to the realities

1 U I f K, Vol 42, p 137

2 "Das Wirtschaftsjahr 1937," Pester Lloyd, December 25, 1937

of the situation, artificially favorable terms of trade and protection disappeared *pari passu*, there remained only the fiction of parity and the tremendous apparatus for providing trade channels over informally devalued rates. Administrative recognition of pengo depreciation lagged behind events, but in the main this was the course followed in Hungary. Why, then, was not the pengo officially devalued and foreign payments liberated from most of the trammels of exchange control? At least three opportunities for the step presented themselves before the recent advent of war closed off the possibility of currency reforms.

The first opportunity was afforded by the devaluation of the Austrian Schilling. During 1933 and 1934, when the Austrian National Bank by a series of subtle steps permitted the *de facto* devaluation to become increasingly patent and overt, Austria accounted for a larger share of Hungarian exports and imports than any other country.¹ Furthermore, the pengo and Schilling had suffered about the same degree of *de facto* depreciation at least until the middle of 1934. It will never be quite clear that the Hungarian authorities acted wisely in passing by this opportunity. The panic psychology and fear of inflation characterizing the financial crisis of 1931 had subsided and the bottom of the depression had already been passed. But there were three respects in which Hungary's economic and financial structure was weaker than Austria's. Unlike Austria, Hungary had received no foreign loan to support the central bank in liquidating some of the worst consequences of depression,² the agricultural depression bore much more severely upon Hungary, and finally Hungary had nothing parallel to the working agreement with foreign short-term creditors incorporated into the Credit-Anstalt funding arrangements.

While the first opportunity was admittedly not a clear case, the second, afforded by the gold-bloc devaluations in September, 1936, was much less ambiguous. Here again the proportion of Hungarian trade involved with the five devaluing countries was substantial — 16 per cent on the side of imports and 26 per cent of exports. Most significant, however, was the prospect that the era of important devaluations had apparently come to a close,

¹ Imports, 20 per cent and 23 per cent in 1933 and 1934, exports, 27 per cent and 24 per cent. The next rival was Germany at 19.7 per cent and 18 per cent, and 11 per cent and 22 per cent.

² Kemény, in Österreichischer Volkswirt, Vol. 27, p. 347.

so that the Hungarians needed no longer to fear substantial changes in the pound and dollar, an obstacle frequently adverted to throughout the period 1931-36¹. Agricultural prices had shown marked improvement, budgetary deficits had fallen steadily and the pengo had shown remarkable stability for two years. The revision of clearing rates of exchange with gold-bloc countries and the subsequent abolition of clearing with France and Switzerland afforded occasions when the pengo might gracefully have been devalued.

Early in 1934 Count Bethlen advocated the abolition of the fictitious value of the pengo as soon as four conditions were fulfilled (1) that the budget be brought to balance, (2) that reliable export markets be secured, (3) that the Hungarian National Bank experience a substantial increase in its reserves, and (4) that an understanding be reached with Hungary's foreign creditors.² In passing it may be remarked that Austria achieved the virtual abolition of exchange control without any of these conditions being realized in her own economy. By the summer of 1937, with the successful culmination of the debt agreements, all these conditions may fairly be said to have been realized in Hungary. Foreign commentators confidently predicted revision of the official valuation of the pengo,³ and yet the step was not taken. Somewhat belatedly in January, 1939, the reserves of the National Bank were revalued at 50.2 per cent higher values in pengo, tantamount to a one-third devaluation. But Hungarian national policy was already caught in the ruck of the German advance to the east, under the domination of German exchange control and the Mark sphere of influence, Hungary remained as one of five countries whose currencies had not been devalued since 1929 — Germany, Bulgaria, Hungary, Lithuania and Poland.

1 Economist, Vol 117, p 816

2 Österreichischer Volkswirt, Vol 26, p 417

3 Economist (June 5, 1937), Vol 120, p 572

CHAPTER IV

GERMAN EXCHANGE CONTROL, 1931-1939 FROM AN EMERGENCY MEASURE TO A TOTALITARIAN INSTITUTION

THE INTRODUCTION OF EXCHANGE CONTROL

Exchange control has been hailed by writers in National-Socialist Germany of recent years as a system of "modern money"¹. This vaunting enthusiasm for the modernity of currency standards under exchange control houses strangely with another widespread quasi-official doctrine that exchange control accomplishes the same ends as the old scheme of free payments under a now obsolete "liberal" system of international trade. "The transfer of a bank deposit to London through free bills of exchange is exactly the same as if the deposit-owner made expenditures from his 'exclusively for domestic payments' account."² Precisely because this statement is *not* true, as will be further elaborated in the concluding chapter,³ do currencies under exchange control represent something new and novel. But the novelty or modernity of such currencies consists rather in the disintegration of monetary system than in its appearance, as a retrospect into the historical origin of exchange control will reveal. Both within the international and national spheres, system gave place to *ad hoc* arrangements. It is well to recall the origin of "modern money" in the financial chaos of 1931, for exchange control currencies never divested themselves of the impress of their genesis. It is well to inquire into these origins for another reason: economic writers in the present German regime are fond of giving the impression that exchange control is a proud *tour de force* of the totalitarian state. Whether or not the control of foreign payments is indispensable to such a political system, it is worth remarking that the National Socialists inherited it from Social Democrat supported Coalition governments after nearly two years of elaboration.

A *The Situation Preceding Exchange Control*

When, in May, 1931, the collapse of the Austrian Credit

1 Carl Hermann Muller, *Grundriss der Devisenbewirtschaftung*, 2d ed (Berlin, 1939), p. 33.

2 Ibid., p. 35, that is, from one of the several "frozen" Mark accounts.

3 Cf. p. 290 below.

Anstalt sent a wave of panic over the financial world, Germany was already in a state of advanced economic contraction and rapidly progressing social and political disintegration. The volume of production had shrunk from 100.2 (1928 = 100) in September, 1929 to 82.5 in December, 1930,¹ and the number of unemployed had risen from 1,324,000 to a peak in February, 1931, of 5,000,000. From July, 1929 to March, 1931 money order transfers through the postoffices decreased by 20.5 per cent, sight deposits of the Reichsbank by 24.8 per cent, and bills discounted by the Reichsbank by 27 per cent.² While these series indicative of economic activity in a broad sense shrank markedly, there was a comparatively slight decrease in note circulation, indeed over the same months (July, 1929 to March, 1931) a decrease of only 5.6 per cent. Note circulation pertains primarily to the sphere of consumption, and its relative inelasticity indicates the rigidity of wages, the magnitude of unemployment benefits, and a general lack of plasticity in the price system. Monopolistic wage and commodity price policies greatly intensified the depression. As for the latter, the following contrast of administered and free prices indicates disparities in the German price structure.

PRICES OF RAW MATERIALS AND SEMI-FINISHED GOODS IN GERMANY,
1929-1931*
(1926 = 100)

	Administered Prices			Free Prices		
	1929	1930	1931	1929	1930	1931
January		105	95.2		90.4	66.2
February		105	94.8		87.2	65.6
March		105	94.7		84.9	65.6
April		105.1	94.0		85.2	65.0
May		104.9	93.9		84.7	62.8
June		103.9	94.0		82.6	61.4
July		103.3			78.9	
August		102.7			76.8	
September	105.3	102.5		96.6	74.8	
October	105.3	101.7		95.1	72.2	
November	105.3	100.7		93.2	70.6	
December	105.3	97.1		92.2	68.3	

* V z K Vol 6 Part A No 2 p 53 No 3 p 50 No 4 p 54

1 Institut fur Konjunkturforschung (Berlin), Vierteljahrssheft zur Konjunkturforschung, Vol 7, Part A, No 1, p 264. Hereafter this publication is referred to as V z K.

2 V z K, Vol 6, Part A, p 43

As for wage rates, the index of wages determined by collective bargaining contracts stood at 105.5 (1928 = 100) in 1929, actually rose in 1930 to 107.3, and declined only slightly to 102.1 in 1931.¹ As depression continued, it is true, wage rates of collective contracts became less representative, because of short-time work, the disappearance of overtime, and numerous evasions. But in view of the tremendous fall in employment, the decline in aggregate labor income seems very small — from 42,621,000 Reichsmarks in 1928, to 43,045,000 and 39,600,000 Reichsmarks in 1929 and 1930.² This amounts to only a 7.5 per cent reduction in the money wage-bill between 1928 and 1930, or to a mere 4.3 per cent in the real wage aggregate.³

The constellation of rigid monopoly and trade-union prices with a rapidly contracting volume of production was bound to produce violent social and political struggles. Negotiations carried on in 1930 between representatives of the labor unions and the employers' associations came to naught, inasmuch as "the employers insisted on wage reductions in order to reduce prices, whereas the labor unions held that price reductions should precede wage reductions in order to preserve mass purchasing power."⁴ In the ensuing struggle for the division of a shrinking national dividend, state expenditures for unemployment relief played a crucial rôle, especially in view of a popular demand for budget equilibrium despite dwindling tax revenues. During the recovery years 1925/26 to 1928/29 the growing expenditures of the Reich had been financed partly through deficits, amounting in the aggregate to 2,255,000,000 Reichsmarks.⁵ The policy encountered little adverse criticism as long as prosperity lasted, but when depression began and the safety of the currency came into question, the German public, schooled by the post-war experience, began to associate budget deficits with a threat of inflation. The labor unions, reflecting this attitude, strongly favored a balanced budget, but insisted that it be achieved by increased taxation upon the propertied classes, even to covering the additional load of unemployment benefits.

1 V z K, Vol. 7, Part A, No. 1, p. 30

2 Statistisches Jahrbuch für das Deutsche Reich 1932 (Berlin, 1933), p. 527, hereafter abbreviated as Stat. Jhrb.

3 The cost of living fell from 152.6 to 140.6

4 Jahrbuch 1930 des Allgemeinen Deutschen Gewerkschaftsbundes (Berlin, 1931), p. 9

5 C. R. S. Harris, Germany's Foreign Indebtedness (London, 1935), p. 14

Both the unions and the Socialist Party considered liberal relief measures essential to the maintenance of wages and they also favored a moderate program of public works.

All of these policies with the exception of budget equilibrium were defeated in the Spring of 1930 by the overthrow of the Muller government and the accession of Bruning. The new government immediately began upon a course of deflation and budget balancing, cutting the incomes of civil servants, scaling down unemployment benefits, increasing taxation upon workers and consumers, exerting a general downward pressure on wages and finally, rather faintly attempting to reduce administered prices — policies destined to prevail with occasional exception for the next two years. In April a law was passed to reduce the Reich contributions to state unemployment relief and to introduce widespread budgetary economies. The next month the Minister of Finance, Moldenhauer, announced that the budget was in equilibrium, but only a few weeks later the government had to reveal a new deficit of 750,000,000 Reichsmarks as a result of intensified depression. From the outset the Bruning government held a precarious position as a minority party relying upon the votes of the Social Democrats in the Reichstag. In July the Socialists voted against the government's reconstruction program, whereupon the Reichstag was dissolved and the program put into force by Emergency Decree (July 26, 1930). The decree raised the unemployment insurance contributions, introduced a levy on the salaries of officials and unmarried persons, and permitted the municipalities to collect a poll tax as an offset to the heavy burden of their welfare expenditures. Furthermore the decree empowered the government to initiate measures to lower cartel prices, and simultaneously state representatives on arbitration boards exerted pressure toward lowering the general level of wages.

The general elections in September, 1930, revealed the devastating effects of depression upon German internal politics both National Socialists and Communists increased their positions in the Reichstag, the former from 12 to 107 seats. Bruning remained in office and continued his government by emergency decrees, virtually eliminating the Reichstag. Caught between the upper and nether millstones of National Socialism and Communism, the Social Democrats had no alternative but passive "toleration" of the government, as the phrase went. This resulted in the curious phenomenon of actually decreasing frequency of strikes during a

period of severe deflation, in 1927 the number of laborers involved in strikes was 632,000, in 1930, 274,000, and in 1931, 156,000.¹ Reductions in unemployment benefits, salary cuts, and the slow progress of cartel price-lowering caused deep dissatisfaction and drove large numbers not only of unemployed laborers but also of the middle-class into the radical right and left wing parties.

The general elections of 1930 and the atmosphere of impending civil upheaval, especially in the form of a National Socialist *coup*, struck a fell blow at business confidence concerning Germany both within and outside the country. German securities declined sharply on foreign markets in the early Autumn. The dangers besetting foreign short-term loans, imperfectly sensed until now, came to be apparent, foreign capital for the first time since the 1928/29 downturn was withdrawn in large quantities — 800,000,000 Reichsmarks within a single month, and by December 17, something over double this sum. A new budget deficit of a billion Reichsmarks accumulated shortly after the election, and it was only by virtue of a 400,000,000 Reichsmark issue of Treasury bills and the Lee Higginson loan of \$125,000,000 that the difficulty could be tided over. A few days later the Reichsbank reluctantly raised its rediscount rate from 4 to 5 per cent. Inconsistently with Bruning's deflationary policy, the Reichsbank discount rate had been dominated by the so-called *Konstatierungspolitik* since the Autumn of 1929 — the principle of adapting the rate to London, where increasing liquidity had brought down bank rate from 6 to 3 per cent. Accordingly the Reichsbank had lowered its rate, preserving the usual differential between London and Berlin, from 7½ to 4 per cent at the middle of 1930, the lowest rate permitted by its statutes.

The year 1930 marked a thoroughgoing change in the aspect of Germany's balance of payments. The continuous inflow of

THE BALANCE OF PAYMENTS OF GERMANY, 1927-1930*
(In million Reichsmarks)

Capital exports, —, capital imports, +

	Long Term	Short Term	Unclassified	Total
1927	+1,778	+2,264	+ 310	+4,352
1928	+1,788	+1,270	+1,000	+4,058
1929	+ 660	+ 484	+ 879	+2,023
1930	+1,119	+ 169	- 746	+ 542

* League of Nations Balances of Payments 1937 (Geneva 1938) p. 108

capital since 1924 had exceeded by $2\frac{1}{2}$ to 3 times the 10,300,000,000 Reichsmarks paid by Germany for reparations,¹ but in 1929 the flow began to slacken. The item of 879,000,000 Reichsmarks under "unclassified" capital imports indicates that outside the (formally organized) credit organizations of Germany the inflow of short-term loans continued almost unabated,² though the total capital influx was halved for the year. The total figures given above fail to show the extent of the disaster in 1930. In that year the 1,800,000,000 Reichsmark Young Loan was floated, although two-thirds of the proceeds went to reparations, the remaining third, used to finance the German railways, afforded considerable relief to the balance of payments. Nevertheless the net inflow of capital dwindled to a half billion marks, or one-eighth its magnitude two years earlier. This figure does not reveal, furthermore, that during the second half of the year short-term capital imports practically vanished, nor that capital withdrawals in the aggregate amounted to over a billion and a half marks.

Under these circumstances the balance of trade took a spectacular turn from unfavorable to favorable. This change was greatly intensified by the alteration of the terms of trade for

GERMAN IMPORTS AND EXPORTS, 1928-1930*
(In million Reichsmarks)

	Imports	Exports	Balance
1928	13,649 5	12,420 1	-1,229 4
1929	13,446 8	13,482 7	+ 35 9
1930	10,393 0	12,035 6	+1,642 3

* Including reparation deliveries in kind Cf Stat Jhrb 1932 p 173

Germany following the collapse of markets for raw materials in the depression. Just how important an influence this represented may be discovered by applying monthly average values during 1929 to the 1930 figures. Imports in 1930 would have a value of 12,055,-500,000 Reichsmarks, exports 12,871,000,000 Reichsmarks, and the favorable balance 815,600,000 Reichsmarks or less than half the actual export surplus. We shall have occasion later to point to the significance of this favorable turn in the terms of trade for

1 Harris, op cit., p 10

2 Statistisches Reichsamt, *Die deutsche Zahlungsbilanz der Jahre 1924-1933* (Berlin, 1934), p 22

Germany's economic position generally, but in the midst of the political and economic crisis of late 1930, it was not a sufficiently obvious fact to aid in the restoration of confidence. The loss of gold and devisen from Reichsbank reserves continued and only in February, 1931, did the drain show signs of temporarily retarding.¹

During 1930 the government found itself so preoccupied in trying to cope with an increase of the budget deficit of two billion Marks² by intensifying the measures already initiated, that more fundamental economic corrections went by default. The policy of "deflation" revealed marked incongruities. Extensive increases in protective tariffs and subsidies accorded to agriculture drove prices in this segment far above the world market level. On the other hand, endeavors to lower cartel prices did not go beyond a decree on January 31, 1932, which annulled contracts between manufacturers of branded goods and their distributors, unless the manufacturers reduced prices by 10 per cent from the previous July.³ Practical effects from the measure were nugatory. On March 30, 1931, a "saving budget" came into force by emergency decree, but despite a contemplated saving of 1,150,000,000 Reichsmarks under the 1932 budget, a new deficit had accumulated by May. The news of this debacle impinged upon a panic situation created by the breakdown of the Credit Anstalt.

The month of June, 1931, witnessed a rapid increase of political tension. The radical press of both left and right wings predicted the collapse of capitalism in Germany and the breakdown of the Versailles system, thus Schacht, then at an interim period of retirement from the Reichsbank presidency, proclaimed that Germany's ability to pay had come to an end and that a dictatorship was inevitable. Appalled by the growth of National Socialism, the government on its side attempted to take the wind out of the sails of the movement by concluding a customs union with Austria. The failure of the Austrian Credit Anstalt enabled the French to intervene and wreck the *Anschluss*, but the resurgence of anti-German sentiment in Paris forced the Reichsbank to look elsewhere for help in the emergency. New York had not recovered from the stock-exchange crash of 1929 and the position of London was

¹ Cf Appendix, pp 373-376 below

² Wirtschaft und Statistik, Vol 11, No 5 (March, 1931), p 207

³ J W F Thelwall and R P E Edwards, Economic Conditions in Germany to September, 1931, Department of Overseas Trade (H M Stat Office, London, 1932), p 12

becoming increasingly difficult. In these straits the Reichsbank had no further resource than the \$50,000,000 American credit already provided for in 1927. The government itself seemed to be largely without counsel, save for further resort to long-run equilibrium measures such as curtailing unemployment insurance benefits by 400,000,000 Reichsmarks, lowering the salaries of civil servants by 4 per cent to 8 per cent, and the introduction of a crisis surtax on wages. Meanwhile the commercial banks, in order to replenish reserves sapped away by the capital flight, turned heavily to the Reichsbank, which experienced a sharp rise in bills discounted.¹ An advance of bank-rate on June 14 from 5 per cent to 7 per cent accomplished nothing toward stemming the tide. By the time the Hoover Moratorium was announced on June 16, the Reichsbank had lost a billion Reichsmarks in reserves and was approaching the limit of the 40 per cent reserves required against its notes. The man in the street watched the approach to this sacred line with superstitious misgivings and expected an immediate collapse of the currency system once the limit was exceeded.

Had the Hoover proposal met with immediate acceptance, it might have turned the scales in a delicate state of public psychology. Still smarting under the attempt at *Anschluss*, France confronted Germany with a series of political demands, hesitated as to the amount of "unconditional" reparations, and demanded the strictest scrutiny of Reichsbank credits to industry. Up to July 6, when the "Hoover Year" was finally inaugurated, the catastrophic position of Germany was continually the center of discussion of a sort to impart the *coup de grâce* to confidence in the country, both at home and abroad. When the news finally came that Germany had been permitted to suspend the payment of 1,617,000 Reichsmarks in reparations for the period July to July, 1931-1932, and even to make only a nominal tender without actual payment of the "unconditional" annuity of 600,000,000 Reichsmarks,² the psychological effect was explosive, rather than restorative.

An emergency credit of \$100,000,000 extended on June 25 by the Bank for International Settlements and the central banks of England, France, and the United States was to an extent exceeding one-half dissipated by the capital flight within a span of five days.

1 Cf Appendix, pp 373-376

2 *Economist*, Reparations and War Debts Supplement, January 23, 1932, p 7

Nor was the situation materially helped by a joint guarantee to the Golddiskontbank of 500,000,000 Reichsmarks by a thousand of the largest German firms. On July 11 it transpired that the government was preparing sharp measures against the outflow of devisen. Shortly thereafter the Darmstädter-und-Nationalbank failed as a consequence of the scandalous bankruptcy of the Nordwolle-Konzern. The Reichsbank came to the view that the old principle of stopping runs by a heroic willingness to convert credit to cash was inapplicable in a situation in which withdrawals resulted only in an equivalent loss of devisen to foreign countries. Bank holidays were proclaimed, the Reich undertook guarantees of depositors' claims, the Stock Exchange was closed, and finally by a series of decrees between July 15 and August 1 exchange control was introduced. The system later glorified as "modern money" had made its inglorious advent.

B Control as an Emergency Device to Check the Flight of Capital — July through November, 1931

On January 1, 1939, a general recodification of all exchange-control regulations came into legal effect for Greater Germany. Since its inception in the crisis of July, 1931, "modern money" had required three general exchange-control laws, upwards of 50 separate decrees of amendment and adaptation, and something in the neighborhood of 500 administrative rulings,¹ to say nothing of clearing, compensation, and payment agreements with partner countries. It is not necessary except on rare occasions to enter into this juristic maze, but a brief examination of the earliest measures serves to characterize the legal structure of exchange control in Germany throughout.

Six decrees on July 15, 16, and 18 put control into operation on an *ex tempore* basis before the First Devisen Law of August 1. These decrees² gave to the Reichsbank a monopoly of dealings in foreign exchange, prohibited all deviations from the official rate of exchange, and abolished forward transactions in devisen. Owners of foreign claims and means-of-payment in foreign currencies exceeding 20,000 Reichsmarks could be, and within a few days actually were, required to sell them to the central bank. Although foreign securities had to be registered, the purchase of such securi-

1 Muller, op cit., pp. 9-10

2 1931 I Reichsgesetzblatt, pp. 365, 366-368, 369, 373-376

ties was not forbidden. Nor was it forbidden to purchase devisen with German securities nor to exchange devisen against devisen. The Reich postal authority did prohibit the export of Marks through the mails, but it was only by implication that the decrees laid a general embargo upon the exportation of German money. Finally, residents of Germany who held an equity in a foreign enterprise exceeding half the total equities, provided there were no more than five owners in the enterprise, were obliged to declare this fact to the control authorities. In this way a flight from taxation as well as a simple capital flight, it was believed, could be checked.

Stipulations of this sort naturally left many doors open for evasions, and little more was actually accomplished than the proclamation of an official rate and securing a small flow of devisen through compulsory sale to the Reichsbank. These shortcomings led to more rigorous measures, especially after the collapse of the World Economic Conference in London and the failure of the Dresdner Bank. On August 1, before the first steps were taken to open the German banks, the first formal Devisen Law¹ came into force by proclamation.

Hereafter devisen could be sold by the authorized devisen-banks only after the purchaser had presented a "certificate of necessity" issued by the newly erected Devisen Offices. A similar certificate was required for purchasing any foreign security not regularly quoted on the German bourses. To extend control over capital exports, the law required the permission of a Devisen Office (1) to open new credits in terms of Marks to foreigners, (2) to dispose over Mark accounts in Germany owned by foreigners and originating before August 4, 1931, (3) to transfer Marks to accounts held with firms abroad. The last prohibition was supplemented by a general embargo upon exporting domestic means of payment. It should be noted, however, that all these prohibitions extended only to transactions over 3,000 Reichsmarks. This rather striking latitude, coupled with the lack of effective control over the actual utilization of devisen, once they had been officially allocated, still allowed many loopholes for capital flight. On the other hand, immediately after publication of the decree the potential powers of the newly created instrument of exchange control were clearly demonstrated: the Devisen Offices received instructions

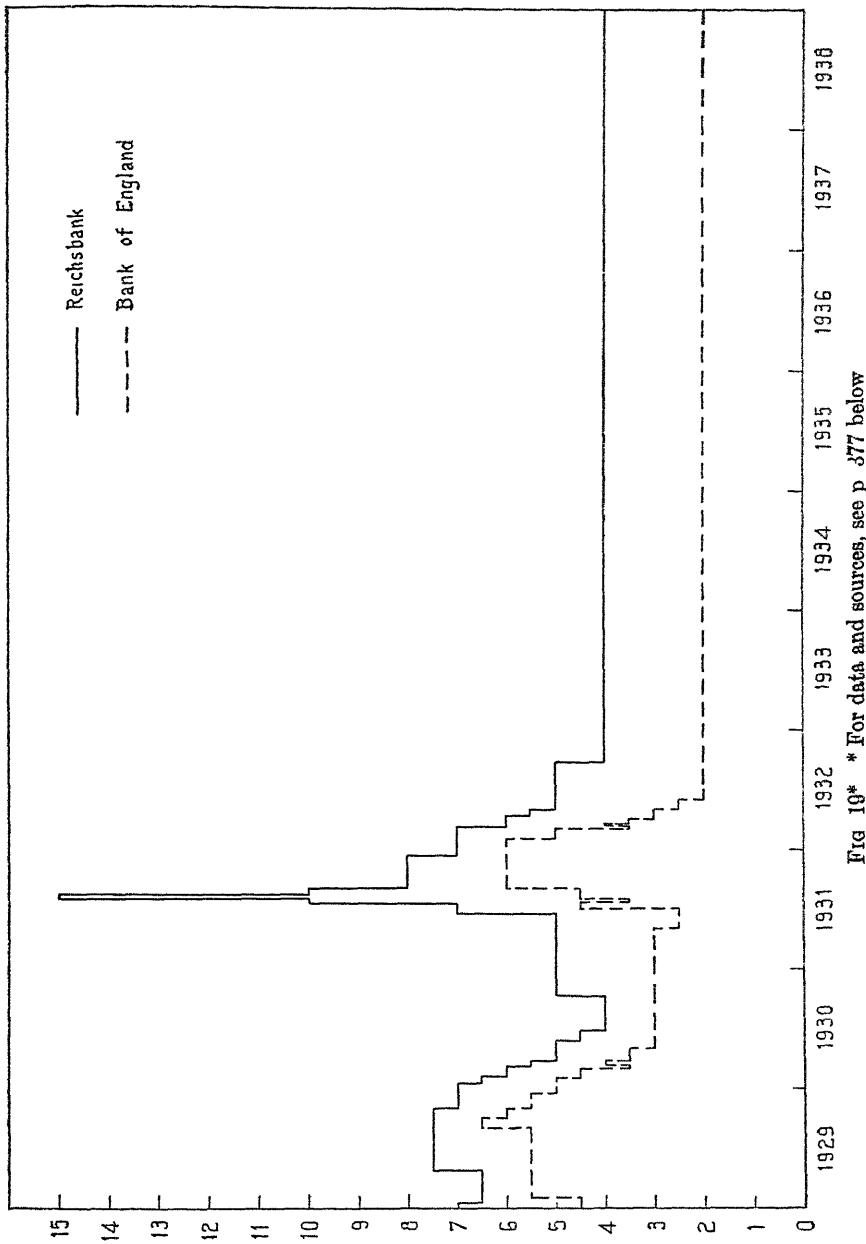
1 1931 I Reichsgesetzblatt, pp. 421-425

to sell devisen freely for certain "vital" imports, to ration devisen for half-finished goods, and to terminate allocation for coal and for finished goods including food. This measure — the influence of agricultural protectionism was apparent — led within a few days to a considerable advance in prices, which seemed sadly at variance with the aim of the prevailing 15 per cent Reichsbank rate. The scheme was shortly given up in favor of unlimited allocation for authentic imports, but not too soon to afford a foretaste of exchange control of the fifth type delineated in the introductory chapter,¹ of exchange control as an instrument of commercial or political policy.

When, under circumstances which scarcely could have been more dramatic, Germany abandoned the free-payments system and resorted to an official exchange rate and the control of payments, there was little doubt at home or abroad that this was an emergency measure. No one would have supposed that it was destined to be the outstanding feature of the German economy for years to come. The enactment of exchange control sprang directly from a deep crisis in confidence, and this in turn had been gestated in a year of grave political unrest, with a people demoralized by the trying experiences of war, revolution, post-war inflation, and the Versailles system of reparations. But the crisis in confidence could not have assumed so devastating a character, had it not been for the precarious situation of German foreign indebtedness.

Germany emerged from the post-war inflation with its fixed capital equipment sadly impaired and its working capital exhausted. Surprisingly enough, after the Dawes agreement of 1924, confidence of the international financial world regarding Germany was restored even more rapidly than it was destroyed seven years later. Long-term capital began to move into the country, slowly at first, but in 1926, when the stabilization slump had given place to a pronounced recovery, at a greatly accelerated rate. For German industry this was a period of rapid rationalization of plant, but at the same time the states and municipalities began indulging in expensive schemes of social reconstruction. The Social Democrats lacked the strength to impose sufficient taxes for these plans, and instead lightheartedly resorted to borrowing. It is by no means easy to account for the large inflow of short-term capital beginning in 1927, though a part is ascribable to the increase of German

1 Cf p 6 above



imports by four billion Marks between 1926 and 1927. In large part the explanation lies in the myopia of foreign lenders who, to secure the current exorbitantly high money rates, were willing to ignore the consequences of the German practice of investing short-term funds in fixed capital equipment. The six largest banks in Berlin showed short-term liabilities to foreigners amounting to 43 per cent of total liabilities by the end of 1928.¹

The extent and nature of capital imports by Germany during the recovery years appears in the following figures.

CAPITAL MOVEMENTS INTO GERMANY, 1924-1929*
(In million Reichsmarks)

Year	Long Term	Short Term	Unclassified	Balance on Current Income
1924	1,000	1,500	400	2,900
1925	1,110	300	1,700	3,100
1926	1,400	100	900	600
1927	1,700	1,800	400	3,900
1928	1,700	1,400	1,200	4,300
1929	600	1,110	1,000	2,700
Total	9,100	6,200	2,900	18,200

* Economist Reparations and War Debts Supplement January 23 1923 p 10

Estimates differ appreciably as to German foreign indebtedness at its peak in mid-1930 on the eve of the crisis. The Wiggin Committee in August, 1931, set the figure at 25,500,000,000 Reichsmarks, while the official German estimate, submitted to the Young Plan Committee early in 1931, ran to 30,000,000,000 Reichsmarks.² A total of 26,800,000,000 of foreign debts in mid-1930, according to the latest data published by the League of Nations,³ was divided into long-term and short-term respectively at 10,800,000,000 and 16,000,000,000 Reichsmarks. Of the capital entering Germany over the years 1924-1930, 10,300,000,000 Reichsmarks went into reparation payments, 6,300,000,000 Reichsmarks to pay for import surpluses, 2,500,000,000 Reichsmarks to interest on commercial debts, and about 2,500,000,000 Reichsmarks to the reserves of the

1 Deutsche Wirtschaftskunde (Berlin, 1930), p 244.

2 C S R Harris, Germany's Foreign Indebtedness (London, 1935), p 8.

3 League of Nations, Balances of Payments 1937 (Geneva, 1938), p 109.

Reichsbank, which more than trebled.¹ The capital withdrawals and flight of 1930–1931 absorbed three billion Reichsmarks and left the debt at 10 700,000 000 Reichsmarks at long-term and 13,100 000,000 at short-term. As for the short-term debts, only 23 per cent represented acceptances, and even here there is little doubt that much had been invested in such a way as to render the supposed self-liquidating character of these credits illusory. German short-term borrowings were actually "frozen" before the introduction of exchange control made this fact plain.

The London Conference, meeting in the midst of the crisis in July, appointed a committee under the chairmanship of Wiggin to investigate the German short-term debt situation. At the same time — a circumstance which greatly facilitated the reopening of banks — the English bankers agreed not to withdraw their credits. Ensuing negotiations toward a Standstill were protracted by rigorous conditions of a political character demanded by the French representatives. Agreement was finally reached on September 19, retroactive to the first of the month, between the foreign bankers and German debtors with the participation of the Reichsbank and Golddiskontbank, the basic principle being a maintenance of existing credits without alteration of their original terms. Unfortunately the First Standstill was not without its shortcomings. It was concluded for a period of only six months, though no one could reasonably expect a significant change in so short a time. It included 6,300,000,000 Reichsmarks, only half of the aggregate short-term debts, call money loans, short-term advances against securities and mortgages, as well as credits to agriculture for financing crops — all these were excluded. No attempt was made to follow the Wiggin Committee's recommendation that part of the credits be converted into long-term obligations. Nor were the short-term debts contracted by states, municipalities, and public bodies incorporated into the agreement. An emergency formula permitting the continuance of German trade had indeed been found. Whether the Standstill laid a basis for the discontinuance of exchange control cannot be known, since within a few days Great Britain's departure from the gold standard created a new situation, to which we come presently.

The institution of exchange control in the July crisis of 1931

1. Report of the Committee Appointed on the Recommendation of the London Conference, 1931 (Basle, 1931), p. 2.

was based upon short-run psychological factors, without much reference to more fundamental monetary determinants. In certain quarters, exchange control encountered distrust; the system might become an instrument of political abuse, it might lead to a black market upon devisen and the ultimate collapse of the currency unit, to these evils even a very high bank-rate was preferable.¹ That the Reichsbank was influenced by such considerations may be inferred from its advancing the rate to 15 per cent on August 1, and its cautious reductions of the rate to 10 per cent on August 12 and 8 per cent on September 2, where it remained until December 10. But the Reichsbank also felt that exchange control was a necessary prerequisite for coping with the crisis in confidence. Foreign creditors, especially American, were anxious to see exchange control tightened,² fearing that devaluation might lead to discriminatory treatment of foreign creditors and also to exchange-dumping, which in turn would provoke defense measures such as to make the debts uncollectable. The German trades unions likewise, possibly under the influences of a vague apprehension of inflation, of a general hostility to foreign capital, and of an underlying tendency toward *Planwirtschaft*, also formally demanded the extension of exchange control.³ These "psychological" motivations of the control originally predominated.

But with the devaluation of sterling another consideration came to equal importance. Examination of the relative course of wholesale prices in various countries presented in Figure 20 demonstrates *ad oculos* how, after lagging behind the movement in other countries from 1929, wholesale prices in Germany lost contact with the world price system in 1931. At first the hesitancy of the government respecting cartel prices was chiefly responsible, but the pound devaluation still more gravely impaired the competitive power of German exports. Exchange control offered no solution of the difficulty in and of itself, but it did afford a breathing space in which to discover and put into effect some *modus vivendi*.

Alternative courses of action were to follow the English example of devaluation or to continue and intensify the course of

1 L. Albert Hahn, a German popular economist of wide repute, proposed a bank rate of 30 per cent.

2 Economist, July 25, 1931, p. 160 and Oesterreichischer Volkswirt, Vol. 23, No. 43 (July 25, 1931), p. 1134.

3 In a resolution of July 29, 1931 Cf. Jahrbuch, 1931, des Allgemeinen Deutschen Gewerkschaftsbundes (Berlin, 1932), pp. 48, 55.

deflation. Without doubt devaluation would afford certain advantages, amongst them most conspicuously an adjustment to foreign prices within a brief interval. The discontinuance of the tedious and unpopular process of deflation would contribute to a quieting of political unrest within Germany, and furthermore the opinion

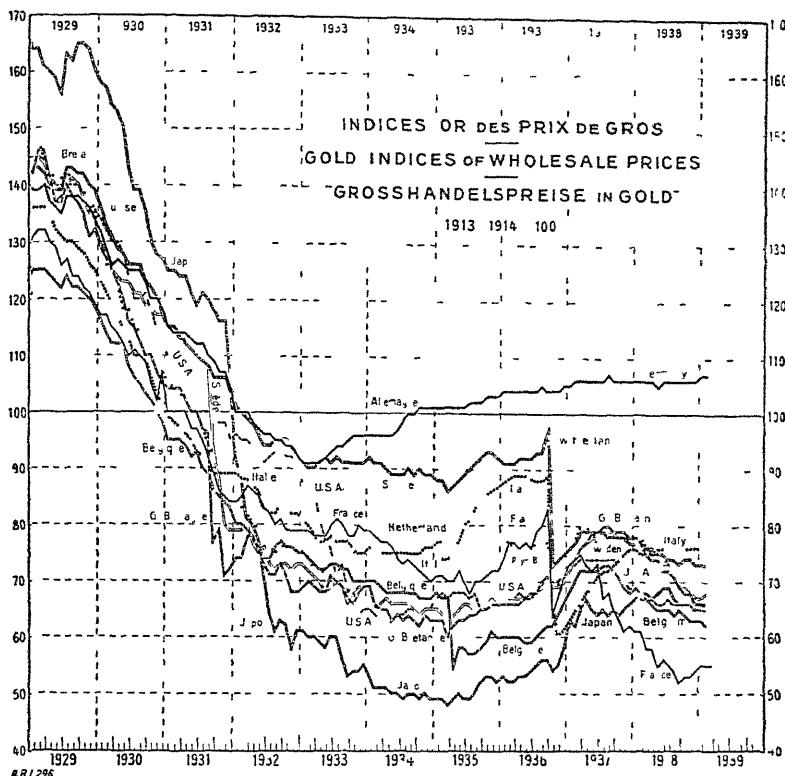


FIG. 20*

* Reproduced from Bank for International Settlements, Ninth Annual Report (Basel, 1939), p. 52.

was held that devaluation would supply a sort of bargaining fulcrum, securing political and financial concessions from France as a price for Germany's offer to return to the gold standard. The necessity of "re-deflation," as devaluation was euphemistically

labelled, found champions rather widely in the press, especially in the columns of *Der Deutsche Okonomist*¹

The Reichsbank and the Bruning government decided, however, to cling to the policy of deflation, and, indeed, serious considerations weighed against devaluation. First and foremost was the threat of a dangerous reaction by an "inflation conscious" populace which did not differentiate between inflation and devaluation. Again, if the trade unions insisted upon an index wage system based on stable foreign currencies as a precaution against the supposed inflation, most of the advantage of exchange depreciation as a method of reducing domestic costs to conform with the international level would automatically disappear. Furthermore, devaluation would raise the value of foreign debts which ran, as most of them did, in terms of foreign currencies. This argument is not completely convincing, in view of the German windfall profits already taken as a consequence of sterling-*bloc* depreciations. But in a creditor country like England devaluation prompted an inflow of capital taking advantage of the opportunity to discharge debts cheaply, whereas no such contribution to the stabilization of currency could be expected for a debtor country.² Finally, it was entirely possible that, in the prevailing pathological state of public anticipations, devaluation might actually precipitate a further spasmodic attempt at capital flight. The day following England's departure from the gold standard, the Chancellor and the Reichsbank President publicly announced their decision against devaluation.

Almost immediately the foreign exchange situation took a decided turn for the worse. The inflow of free *devisen* diminished sharply, because lines of sterling acceptance-credits lapsed through disuse wherever the German customer had become bankrupt. Because the exchange regulations could be evaded in a number of

1. *Der Deutsche Okonomist*, Vol 49 "Zur Devaluation der Finnmark," October 23, 1931, "Ein Program der Devaluation," December 11, 1931. Cf also Dahlberg's address to the Deutsche Weltwirtschaftliche Gesellschaft, October 16, 1931, Kramer, in the *Wirtschaftsdienst*, October 16, 1931, Albert Hahn, in the *Vossische Zeitung*, November 5, 1931, and Pinner, in the *Berliner Tagblatt*, November 29, 1931. In view of his later position, it is interesting to discover the concessions to the devaluation thesis made by Ernst Wagemann, director of the German Business Cycle Research Institute, in the *Wochenbericht* of December 2, 1931.

2. Hans Luther, "Wirtschaftsfragen der Gegenwart," in *Kieler Vorträge*, No 38 (Jena, 1931)

ways, and because the Standstill covered less than half the foreign debts at short term, devisen continued to be drawn off. Capital flight through distrust of the currency and pessimism concerning Germany's future continued, but other motives were in play also. The low sterling rate appealed to the ordinary price calculus in affording a bargain on debt payments, and in addition the German merchant desired to re-establish his position as a trustworthy debtor after the disturbances of the summer months. The temptation of the black market interfered with the flow of devisen into the Reichsbank at its low official rate. Having experienced a loss of 66,000,000 Reichsmarks in devisen in one week after sterling devaluation, the Bank threatened to exclude from rediscounting facilities those firms which infringed upon the exchange regulations. The minimum amount of devisen and other foreign claims exempt from compulsory sale to the Reichsbank was set down from 1,000 to 200 Reichsmarks, and in the next few weeks the control was otherwise tightened by detailed enactments.

Meanwhile the crisis produced its inevitable result upon the budget in a deficit of 2,626,000,000 Reichsmarks by the year end.¹ The government responded in this extremity by promulgating on December 8 its Fourth Emergency Decree, the most drastic effort in two years of deflation policy. On the purely fiscal side a reduction of nine per cent in the salaries of civil servants, already cut by 11-13 per cent, brought a prospective balancing. On the economic side the decree reduced administered prices by 10 per cent of their June 30, 1931 level, established a Price Commission, and lowered contractual wage rates to the level of January, 1927, i.e. by 10-15 per cent. This heroic reduction of wages made it appear mandatory to lower house rents by seven or eight per cent, and this in turn required in consistency a scaling down of mortgage rates. The final step was a general reduction of interest upon all medium- and long-term credits, with a lowering of short-term rates effectuated through cutting the conventional bank commissions. Interest reduction represented the most hotly contested point of the program. Aside from theoretical pro's and con's, it is worth noting that the measure actually came into force by virtue of pressure from agricultural interests, chiefly the East Prussian landowners, whose influence was in the ascendancy. Shortly before the Emer-

¹ Jahrbuch, 1931, des Allgemeinen Deutschen Gewerkschaftsbundes (Berlin, 1932), p. 39, the largest deficit since the post-war inflation.

gency Decree they had informed the Chancellor of their intention to cut wages by one-third and mortgage interest rates to three per cent by unilateral action

Without reference to this immediately impelling circumstance, what may be said in evaluating the interest reductions as a matter of economic policy? On the one hand, it may be argued that a cheap money policy directly negates the deflationary efforts of price- and wage-reduction decrees. On the other hand, it might be held that if the government takes the tack of a general reduction of costs, then not only commodity prices and wage rates, but also interest charges must in consistency be reduced. The force of the latter view appears to be increased by the virtual unanimity of various shades of theoretical opinion upon this one point. Keynesians argue against wage-reductions only upon the grounds of expediency, but if the resistance of trades unions has been broken, then wage-reductions are as eligible a method of securing low interest rates as an expansion of credit. Without accepting the Keynesian position that an impetus to expanding employment can proceed *only* through the one channel of lower interest rates, Robertson proposes a bank rate below the "quasi-natural" level obtaining in depressions.¹ Finally, the typical orthodox position of a decade ago assumed that all prices should be reduced, including as a matter of course interest rates also.²

In my judgment the application of these arguments in favor of low interest to the German situation of 1934 would fail upon one or other of two counts. The argument might, in the first place, assume that Germany could pursue an autarkic credit policy, and that sacrificing the foreign value of the Mark would be a low price to pay for avoiding deflation and further liquidation. This ignores the fact that the Bruning government, for reasons already set forth, could not risk devaluation. On the other hand, the proponents of a cheap money policy might agree upon this point but err in believing that price and wage reductions were a *fait accompli*, so that the application of the interest rate thumbscrew was superfluous. Actually, however, the deflation of prices and wages had gone only part way. Direct observation shows that important segments of the price system were still unaffected. Indirectly, the lacunae of direct

1 D H Robertson, "Industrial Fluctuation and the Natural Rate of Interest," Economic Journal, Vol 44 (December, 1934), pp 650-656

2 Jacob Viner, Balanced Deflation, Inflation, or More Depression (University of Minnesota, Minneapolis, 1933), Section IV

deflation by authoritarian price and wage reduction are revealed by the fact that, even at a rediscount rate of seven per cent, the Reichsbank felt itself threatened by the necessity of resorting to credit rationing. High interest rates were indispensable to complete the task left unfinished by direct operation upon prices.

The Fourth Emergency Decree signalized the determination of the government to press forward a deflationary policy by eliminating such lacunae. But, at best, deflation requires time. Exchange control, introduced as an emergency or short-run measure *par excellence* to cope with the irrational forces of capital flight, was transformed into a medium-term arrangement. From the middle of 1932 onward, the German government abandoned attempts to restore equilibrium with international prices and therewith accepted exchange control and the overvalued mark as long-run features of the German economy. We turn to the complexion of economic life in Germany during this intermediate term of exchange control prior to the advent of National Socialism.

EFFORTS TOWARD INTERNATIONAL PRICE EQUILIBRIUM UNDER EXCHANGE CONTROL—DECEMBER, 1931 TO FEBRUARY, 1933

The balance of payments for 1931 showed an outflow of 3,350,000,000 Reichsmarks in capital flight and uncontrolled repayments, this sum being offset on the export side by an unprecedented favorable balance of trade of 2,827,000,000 Reichsmarks and a loss of devisen which cut the Reichsbank's reserves in half.¹ Compared with these results, the balance of payments in 1932 indicates that the efforts made to restore normal conditions were not unsuccessful. A slow drain upon the Reichsbank's reserves took a further 200,000,000 Reichsmarks in gold and devisen during 1932. Adding to this an amount of 252,000,000 Reichsmarks from the favorable balance of goods and services, we obtain 452,000,000 Reichsmarks, and this total is counterbalanced by 450,000,000 Reichsmarks repaid upon long-term loans to the Reich, the central bank, and the Golddiskontbank. Even if the statistics are not altogether accurate, there is little room for a flight of capital.

For the more normal aspect of the balance of payments in 1932, two factors were chiefly responsible—the extending and broadening of the Standstill, and the Lausanne conference con-

¹ Die Deutsche Zahlungsbilanz der Jahre 1924–1933, p. 22, and Wirtschaftstatistisches Jahrbuch 1931/1932 (Vienna, 1933), p. 13.

cerning reparations. The first renewal of the Standstill agreement for the twelve-month beginning with February, 1932, recurred to the suggestion of the Wiggin-Layton Committee and provided for the conversion of unsecured short-term credits at the option of the creditor to 10-year gold notes at six per cent. Creditors might also utilize a maximum of 50 per cent of their advances for the purchase of German securities, which remained "blocked" however for five years thereafter. This was the origin of one category in the system of blocked marks, destined to become an integral part of German exchange control. The Standstill renewal involved also a guarantee of the Golddiskontbank for certain short-term credits and the reduction of unutilized lines of credit. The German debtors secured a promise that interest rates would be reduced to some conformity with rates in the creditor countries. By the time the agreement was concluded, repayments and sterling depreciation had brought the aggregate of included credits to 5,000,000,000 Reichsmarks, or 20 per cent less than their original amount.

Creditor concessions in funding short-term credits and debtor demonstrations of genuine desire to repay created an atmosphere of goodwill. Two months after the Standstill renewal a supplement included municipal obligations and reduced interest rates in this field from nine to six per cent. There remained outside the Standstill 5,100,000,000 Reichsmarks short-term debts of German individual and corporate enterprises to non-banking firms abroad, and a further 5,300,000,000 Reichsmarks comprising chiefly the obligations of German firms to foreign affiliates, wherein the debtor relationship frequently departed somewhat from a strict short-term character. Although the Standstill embraced only a third of Germany's short-term debts, its favorable psychological effect undoubtedly extended over the entire range of foreign indebtedness.

Another milestone on the way to a normal balance of payments was reached at the culmination of reparation negotiations. One of the great merits of the Wiggin report lay in its unambiguous declaration that a final solution of the reparation problem was a prerequisite to the restoration of international credit. Political difficulties in France and Germany caused a postponement of the conference at Lausanne from January, 1932, to June 16. After three weeks of debate the delegates reached an agreement besides the service upon the Dawes and Young loans, the Belgian mark

claims, and the American "mixed claims," amounting in total to 230,000,000 Reichsmarks annually, Germany undertook to pay 3,000,000,000 Reichsmarks for obligations postponed from the "Hoover year," provided the Bank for International Settlements should be able after three years to place the German bonds at 90 per cent of their nominal value. Should this prove to be impossible within 15 years, the bonds were to be destroyed. The arrangement virtually signified the annulment of reparations, which amounted to 30,000,000,000 Reichsmarks under the Young Plan and would have entailed a payment of 1,700,000,000 Reichsmarks in 1932 and 2,400,000,000 *per annum* later.

Whereas the Standstill and reparation arrangements contributed to a consolidation of Germany's position in international finance, the reconstruction of the banks which had collapsed in the summer of 1931 marked a notable step forward in the internal credit situation. The task of reconstruction proved to be easier in Germany, where industry enjoyed a relatively high degree of independence from bank financing, than in Austria, where the Credit Anstalt virtually owned 70 per cent of the industrial capital. In one major instance German industry had even succored the banking system, that is, in the support given by I G Farben, Siemens, Vereinigte Stahlwerke and other large firms to the "Danat" Bank shortly after the crisis. Nevertheless it was to be expected that private capital would not suffice for a thorough-going reconstruction of the banks. The merger of the "Danat" and Dresdner banks chiefly depended upon the Reich, active state aid proved to be necessary in the case of the Commerz-und-Privatbank. In a third case, the Deutsche Bank and Diskonto Gesellschaft, only a limited amount of aid had to be given, this devolved upon the Golddiskontbank after a doubling of its capital. Total participation of the Reich in bank reorganizations amounted to about 500,000,000 Reichsmarks, part of which had, of course, to be regarded in advance as lost. The reorganizations were accompanied by a ruthless clearing of balance sheets with unquestionable benefit to public confidence. Two days after the reconstruction was completed in February, 1932, the Berlin Bourse resumed its activities. So far as concerns finance, both foreign and domestic, Germany had through bank reorganizations, Standstill agreements and the Lausanne conference substantially consolidated her position, but

what is to be said of deeper forces in economic life such as trade, production, and employment?

The favorable balance of trade, having attained a peak in the third quarter of 1931 at 1,001,000,000 Reichsmarks, fell to 907,000,000 in the last quarter of 1932, to 354,000,000 in the first quarter of 1932, and to about 250,000,000 quarterly through the remainder of the year. This resulted over the year in a favorable balance only 37 per cent as large as that of 1931. Had it not been for German exports to Russia, which were supported by long-term credits and other facilities accorded by Germany to offset her high prices, matters would have been still worse. As it was, German exports to European countries declined at about the same rate as the exports of most industrial countries. Exports to non-European countries decreased very sharply, however,¹ chiefly accounting in 1932 for the shrinkage of total exports by 3,800,000,000 Reichsmarks, while the value of imports fell by only 2,000,000,000 Reichsmarks.

That German foreign trade fared relatively worse than that of other countries is explained by sterling devaluation and the lagging pace of deflation within the country. The depreciation of the pound, the growth of protectionism in Great Britain, and later the operation of the Ottawa agreements severely impaired Germany's competitive ability on international markets. In the Balkan countries, for example, Germany lost 50 per cent of her export demand during the first half of 1932, whereas England actually increased exports to the same region.² The heavy odds against which Germany had to struggle are shown in Figure 20 by the plummeting line of British (gold) wholesale prices during 1931 and 1932, and in the striking behavior of British prices expressed in percentages of German prices. For wholesale prices, such a comparison reveals that, if account is taken of the depreciation of sterling in terms of gold, England enjoyed a 20 per cent undercutting margin beginning with the last quarter of 1931. The comparison of export prices on finished goods, probably a more sensitive measure, shows an even greater advantage at the end of 1931 and beginning of 1932, though by the second and third quarters of 1932 the operation of the Fourth Emergency Decree (December, 1931) had appreciably bettered the German position.

1 Cf Appendix, p 385, below

2 V z K , Vol 7, No 2, Part A, p 107

BRITISH AND GERMAN PRICES DURING 1931 AND 1932
(Third quarter 1931 = 100)

Year and Quarter	1	2	3	4	5	6
	British Wholesale in Gold*	German Wholesale Index*	Col 1 as Percentage of Col 2	British Export Finished Goods in Gold†	German Export Finished Goods Index†	Col 4 as Percentage of Col 5
1931	109.4	103.9	105.3	110.2	107.2	102.8
	107.5	102.8	104.6	107.1	104.0	103.0
	100.0	100.0	100.0	100.0	100.0	100.0
	78.5	98.2	79.9	75.4	96.3	78.3
1932	75.0	93.9	79.9	70.3	91.8	74.2
	74.8	93.6	78.9	74.3	92.7	80.2
	69.8	87.3	79.9	68.6	87.8	78.1
	66.0	82.6	79.9	65.1	90.6	71.9

* For data cf Appendix p. 378. The figures have been adjusted to a 1931 base
† VzK Vol 7 No 4 Part A p. 221

The fourth quarter of 1932 with its marked reversal actually belongs to another phase of economic developments

During this year the index of production (1928 = 100) hovered about 60, reaching its absolute low point in August, 1932, at 58, while unemployment never fell below five millions. These figures reflect the general course of depression, but the inability of the German monetary authorities to resort to immediate and avowed devaluation imposed a deflationary policy which accentuated unemployment, at least in the short run. Apart from the special position of the sterling *bloc*, however, and the unforeseeable dollar devaluation a year later, the price situation did not present insurmountable difficulties to the prospective attainment of equilibrium. Throughout 1932 German prices moved in accord with prices in France, as representative of world gold-price economies. The hope seemed to be justified that another strong effort at deflation would completely close the gap between German and gold prices, leaving to the sterling *bloc* the task of conforming to the international gold standard. Voices could be heard in the summer of 1932 urging that, under these circumstances, exchange control should be abolished.

The history of the first nine months of control revealed, however, that the system possessed within itself a strong tendency toward expansion. Some of the measures, such as the lowering of the amount exempted from exchange control from 3,000 to 1,000,

and subsequently to 200 Reichsmarks,¹ represent merely a tightening of existing decrees. Extensions of control into new fields to stop the leakage of devisen seemed to be required, however, not only from the viewpoint of the German authorities charged with husbanding the supply of foreign exchange, but also from the angle of public opinion abroad, which conceived the regulation to be necessary in the interest of the foreign creditors.² On November 2, 1931, the purchase and sale of foreign securities was made subject to special permission of the Devisen Offices.³ But it was the repatriation of German bonds which principally concerned the authorities as a method of evasion. As early as October 3 the publication of free (foreign) quotations on German securities had been suppressed⁴, but the November 2 decree, while permitting foreigners to sell their holdings of German bonds within Germany, forbade the transfer of proceeds abroad.

Exchange control operated through two distinct channels, connected with foreign prices of German bonds, to perpetuate itself. The blocking of outward transfer created an artificial tendency of interest rates in Germany to decline, as reflected, for example, in the gradual reduction of bank rate to five per cent in April, 1932, and it also accounted directly for the low values of German bonds abroad. The combination of high security values at home and low values on the same securities abroad, even in the absence of other motives for a capital flight, would provoke attempts to send funds abroad. Exchange control thus proved

PRICES OF GERMAN BONDS*
(Monthly averages)

	May 1931 New York	May 1932	May 1931 Zurich	May, 1932
7 per cent bonds	92 0	30 8	100 9	54 3
6½ per cent bonds	82 4	23 6	94 6	32 0
6 per cent bonds	79 4	21 3	91 9	32 8
		London		Amsterdam
7 per cent bonds	85 7	58 2	91 5	38 0
6 per cent bonds	84 1	30 1	83 5	31 9

* VzK Vol 7 No 4 Part A, p 192

1 1931 I Reichsgesetzblatt, pp 463, 534

2 Economist, Vol 113, No 4604, p 947

3 1931 I Reichsgesetzblatt, pp 673, 674

4 1931 I Reichsgesetzblatt, p 570

indirectly to be one of the main reasons why its own continuance was necessary. This curious repercussion operated also through a second line of causation as the president of the Reichsbank, Hans Luther, declared with some justification exchange control could not be withdrawn until the foreign short-term credits were successfully converted into long-term obligations.¹ But as long as German bonds stood at the disastrously low levels of 1932, there could be little prospect of floating a German conversion loan.

Because repatriation offered windfall profits on export of capital, because a general apprehensiveness concerning Germany's future effectively stopped any inflow of capital and on the contrary occasioned a continuous alertness to opportunities for capital flight, and finally, because the Mark was overvalued relatively to sterling, the demand for foreign devisen exceeded supply at the official rate and a system of rationing became inevitable. As introduced in November, 1931, the scheme allotted to accredited importers 75 per cent of the devisen used by each firm during the base year July 1, 1930 to June 30, 1931. The quota was reduced to 55 per cent in April and to 50 per cent in May, 1932, and this quota remained in force for nearly two years. The exchange authority maintained that the 50 per cent allocation did not impose an artificial limitation upon imports, inasmuch as both the value per unit and the volume of imports had fallen very greatly through the "natural" course of depression since 1930. The total value of imports fell by 35 per cent from the first quarter of 1931 to the first quarter of 1932, when the 50 per cent quota obtained. Since this shrinkage was the outcome of a 30 per cent fall in average import prices but only a 10 per cent reduction in volume, the authorities held with a fair degree of plausibility that the actual volume of consumption had suffered no more than might be expected, aside from exchange control, in a year of severe economic contraction. However true in 1932, this contention seems to have had less and less validity as time went on, and the qualification was substantial by the early part of 1934.

The possible economic effects of the system of devisen allocation are not exhausted by the question of their adequacy for imports as a whole. The system prevented the appearance of new import firms, virtually precluded any shifting of the relative outputs of firms from their 1930 basis, and afforded to the existing importers a sheltered position at a time when the deflationary

1 Luther, loc. cit., p. 24.

process was imposing a severe struggle for existence on other enterprises. Circumstances of this sort gave rise to the belief within the country that exchange control could be regarded as a protectionist device, akin to the decree of January, 1932, which imposed surcharges upon imports from countries with which no commercial treaty had been concluded. But on the whole, despite the ossifying of the import situation, Germany can scarcely be accused of employing exchange control up to the middle of 1932 as an instrument of trade policy.¹

There was, however, no lack of pressure, both internal and external, toward such an employment. On the one hand, the Association of German Industry carried on active propaganda in favor of altering exchange control so as to "pay more attention to the viewpoint of the national economy."² The Bruning policy of carrying on deflation under the temporary shelter of exchange control encountered difficulty on the international side by reason of the fact that other countries were simultaneously pursuing the same course. In 1931 fifteen European and seven other countries could be counted under exchange control³, and during the first half of 1932 six more countries were added to the list. The number of countries which, like Jugoslavia at the time, held aloof from protectionist and regionally discriminatory practices in connection with exchange control became smaller and smaller. At a minimum, imports of luxuries were throttled in the *devisen* allocation, and although this may not have appeared to be a protectionist measure, it usually operated simply to turn the demand for such products to domestic sources or substitutes. Above this minimum were all degrees of autarkic policy increasingly jeopardizing the maintenance of exchange control in Germany as a purely monetary device, and constantly postponing the time when the deflationary program should have brought about equilibrium in the balance of payments. The original introduction of exchange control by Ger-

1 Cf. in this sense also Thomas Balogh, "The National Economy of Germany," *Economic Journal*, Vol. 48 (September, 1938), p. 480.

2 Alexander Bentheim, "Devisenbilanz, Autarkie, und Schuldendienst," *Der Deutsche Ökonomist*, Vol. 50, No. 14 (April 8, 1932), pp. 441-443.

3 Iran and Portugal had control systems even before the crisis of 1931. During the balance of the year there were added Angola, Argentina, Austria, Bolivia, Brazil, Bulgaria, Chile, Czechoslovakia, Denmark, Estonia, Germany, Greece, Hungary, Iceland, Jugoslavia, Latvia, Nicaragua, and Uruguay. Cf. *Die Währungen der Welt*, published by the Economic Division of the Dresdner Bank (Dresden, no date).

many undoubtedly precipitated and in many cases necessitated similar action by neighboring states but once the controls had become established, there followed a period in which Germany suffered more by foreign efforts at autarky than foreign countries did by her control system.

These difficulties, which obtruded in the shrinkage of exports and the rapidly approaching extinction of the export surplus, led to grave misgivings within Germany as to the ultimate success of deflation under cover of exchange control as a method of securing price equilibrium with foreign countries, and they encouraged resort to devices not fundamentally compatible with such a course. The clearing agreements, to which resort was had in the Spring of 1932, afforded export outlets independently of Germany's completing the program of adjustment through deflation. Furthermore, the device of concealed devaluation through export subsidy presented itself in a beguiling fashion which may have appeared to involve no costs. From the middle of 1932, the Reichsbank began to grant permission to exporters, on condition that it be proven that the particular export sale was "additional," i.e., impossible without this concession, to purchase German bonds at the low foreign values, and with the profits made from resale in Germany to cover the losses of quoting the export good at international competitive prices.

Heuser has taken the position that this device caused the foreign bondholder to bear the costs of export subsidy.¹ While this statement is not necessarily wrong, it may easily be misleading. All that is known beyond peradventure is (1) that exchange control imposed windfall losses upon foreign bondholders, (2) that anyone in Germany repatriating these bonds made a windfall profit, and (3) that the government turned certain sums over to exporters to enable them to meet competitive prices on world markets. To say that the export "subsidy"² was borne by the foreign bondholder implies a *real* linking of the third step with the first, *via* the second. But such a linking is by no means *necessary*. It would be apparent for one thing that, if the German government had resolved to aid exports in all events, repatriation profits

1 Heinrich Heuser, "The German Method of Combined Debt-Liquidation and Export Stimulation," *Review of Economic Studies*, Vol. 1, pp. 210-217.

2 "Subsidy" is figurative only, if the aid merely offset the Mark over-valuation.

or none, the linking of such repatriation profits as were realized with the "subsidy" would be purely arbitrary, since the windfall might as legitimately be taken as the source of *any other* application of national income. Furthermore, the windfall losses to foreign bondholders did not necessarily lead to windfall gains to Germans, for the German government might have endeavored to suppress repatriations altogether in order to relieve the balance of payments from pressure exerted by this capital export. Consequently, neither the link between the third and second, nor between the second and first were *necessary*. To establish a connection between the third and first it is requisite to show that, in actual fact, both links held in the first place that, without repatriation profits, exports would not have been subsidized, and in the second place, that had it not been for the possibility of commandeering these profits for exporters, repatriation would not have been permitted. To make either assertion would be precarious, and by the same token the ascription of the cost of export subsidy to foreign bondholder is also precarious.¹

The promotion of exports through earmarking repatriation windfalls for this purpose represented a concession to the idea of devaluation, which in itself might be regarded as a prelude to abolishing exchange control. Moreover the repurchase of German bonds improved their foreign prices, and this tended to remove one obstacle to the flotation of a German stabilization loan and the lifting of exchange control. Up to January, 1933, these prices improved very considerably — from 100 per cent to 150 per cent — over their level of May, 1932, in the various foreign financial centers.² Even the political events of January, 1933, while adversely affecting German securities in all markets, did not degrade them to their character of *non-valeurs* of May, 1932. During 1932 the Reichsbank began also a policy of encouraging the exchange of German-owned foreign bonds for foreign-owned German bonds,

¹ Just how perilous such conclusions are is well illustrated by Hansen's quite divergent observation on a similar procedure. "The American tourists have thus in fact been subsidized by other Americans who held non-transferable funds in Germany." Cf Alvin Hansen, *Full Recovery or Stagnation* (New York, 1938), p 204.

² The German six per cent bonds rose over the indicated period from 21 per cent to 58 per cent of par in New York, from 32 per cent to 69 per cent in Amsterdam, from 30 per cent to 73 per cent in London, from 33 per cent to 69 per cent in Zurich. Cf *V z K*, Vol 7, No 4, Part A, p 112.

with a resulting favorable effect on the balance of payments¹. Although these policies worked in a direction favorable to the relaxation of exchange control, this effect remained purely theoretical. Actual developments took the opposite course.

The year 1932 was one of swift political change. Because of factors largely outside Germany, deflation did not produce any tangible improvement, on the contrary, whether rightly or wrongly, it was held to be responsible for the further increase in unemployment. The Bruning government was, of course, unpopular with wage earners and the salaried classes, but it found also that neither big industry nor the landed (Junker) interests afforded the anticipated support. German agriculture, traditionally protectionist, could scarcely be content with a program oriented toward reestablishing international finance and trade, and German industry, traditionally free-trade in sentiment, showed an increasing interest in the midst of the exporting crisis in autarkic measures. Furthermore, the situation seemed favorable to the industrialists for a decisive trial of strength with the labor unions, resulting in the elimination of collective bargaining and a further general reduction in wages. The combined attack of these disaffected groups succeeded in May in overthrowing Bruning, who was succeeded by von Papen as prime minister. While the new government could not entertain the idea of a complete reversal of economic policy, as long as the reparation problem continued unsolved, the restiveness of the populace — exemplified by three general elections in the course of 1932 — precluded a mere prolonging of existing policies.

Not until the end of the summer did the new government announce its program. Devaluation and autarky were both disavowed. But it was acknowledged that the "basis of food supply" should be secured within the country, and this implicit recognition of agricultural autarky led within a few weeks to the enactment of new agricultural import quotas. The most significant of von Papen's measures, however, worked toward an almost imperceptible, but nevertheless real, turning away from deflation. Deflationary and reflationary forces were in fact commingled, but there was a shift in the latter direction. Fear of adverse reaction upon the

1. The sale of \$300 worth of Liberty Bonds bearing 3½ per cent interest meant a loss of \$10.50 in interest, with these proceeds there could be purchased German bonds with a nominal value of \$1,000, which at 9 per cent interest meant \$90 gained, thus a net saving of \$79.50 annually on the balance of payments was affected. Cf. *Economist*, Vol. 115, No. 4,657, p. 971.

Reichsmark limited expenditures planned for public works to the relatively modest amount of 135,000,000 Reichsmarks. Chief reliance was therefore put upon certain innovations introduced¹ by the decrees of September 4, 1932 — the issuance of tax certificates, the granting of subsidies to firms employing additional laborers, and the provision for reducing wage rates in conjunction with spreading the work to include new hands. The tax certificates, which were expected to aggregate a billion and a half Reichsmarks were to be issued to payers of certain taxes, and were to be accepted in payment of all federal taxes to the limit of one-fifth over the period 1934–1938. An additional 700,000,000 Reichsmarks of certificates were to be disbursed as premia to firms at the rate of 100 Reichsmarks quarterly for each genuinely new employee. Wage reductions from 10 to 50 per cent on the thirty-first to the fortieth hour per week were authorized on a graduated scale depending on the number of additional workers employed. According to the results of Poole's thorough investigation,² the von Papen tax certificates, which could be rediscounted at the Reichsbank and thus could supply additional funds, actually went largely to liquidating existing debts. But this clearing away of indebtedness paved the way to extensions of production, as Poole maintains, and the ensuing programs of positive credit expansion also encountered less psychological resistance. Had it been possible to proceed to a frank devaluation of the mark at the same time, the door to international equilibrium would still have remained open.

Von Schleicher's government, coming into power early in December, pursued essentially the same policies as von Papen. As a last attempt to resist the National Socialist party, the government tried to come to terms with the labor unions and even offered their leader a place in the cabinet. Because of their unequal benefits as between firms, the wage-reduction premia paid in tax certificates were abandoned, and the additional-employee premia also fell into desuetude. But the Urgency (*Sofort*) Program initiated by Gereke under the Schleicher regime contemplated a public works program of 500,000,000 Reichsmarks and undoubtedly represented an intensification of the von Papen reflationary policy.

The advent to power of Hitler on January 30, 1933, greatly

1 1931 I Reichsgesetzblatt, pp. 425–435.

2 Kenyon E. Poole, *German Financial Policies 1932–1939* (Cambridge, Mass., 1939), pp. 16–73.

increased the drive toward full employment through public works and credit expansion. The First Reinhardt Program, introduced as part of the First Four-Year Plan on June 2, provided for the expenditure of a billion Reichsmarks for house repairs, road building, suburban housing colonies, rural settlements, and waterways.¹ Somewhat later a scheme for automobile highway construction outlined the spending of the exorbitant total of three and a half billion Reichsmarks. Both schemes were to be financed by work-creation bills drawn by private contractors, discounted by banks, and rediscountable at the Reichsbank — a system which contravened if not the letter at least the intent of the Reichsbank statute prohibiting rediscount and open-market dealings in government obligations.² The Second Reinhardt Program of September appropriated a half billion Reichsmarks for house repairs alone, and added 560,000,000 Reichsmarks for plant extensions by the postal and railway authorities. Tax exemptions on work-creating undertakings were introduced, and tax certificates up to the termination of the practice in June, 1933, were issued to 952,000,000 Reichsmarks.

With the adoption of these plans a course was being pursued quite counter to the restoration of price and cost equilibrium with foreign countries. The distance from equilibrium was soon to assume a magnitude which no deflationary policy could conceivably eliminate. There remained as alternatives only an open devaluation or devaluation concealed beneath exchange control, and in the latter event, exchange control would become a permanent feature of the economy.

ON THE ROAD TO BILATERALISM IN TRADE

"Economic policy," so-called, seldom represents anything as rational, predetermined, and consistent as the term might connote. The metamorphosis in Germany from deflation to a make-work expansion of credit appears as a series of merely expedient measures gradually prolonged into a general course of action. The central tendency of 1933 nevertheless represented national autonomous action, the perpetuation of price and cost disequilibrium with foreign countries, and implicitly the acceptance of exchange

¹ Cf C W Guillebaud, *The Economic Recovery of Germany* (London, 1939), pp 38-43.

² Cf Poole, *op cit*, p 103 ff.

control, not only as it stood, but even in more intense form. Even such a country as Austria after 1933, maintaining the second type of control identified above, found it necessary to continue a full complement of clearing agreements and to carry on a good deal of local interference in order to guard against capital flight. This was the case despite the conformity of the Schilling rate with its equilibrium level. But even before February, 1933, Germany belonged to the fourth category of control¹: the mark was overvalued not merely by reason of excessive capital exports, which in isolation would have brought her into the third category of exchange control, but also by reason of her lagging deflation relatively to other countries. The overvaluation of the monetary unit added fire to the flames of evasion and necessitated a still more strict control, but overvaluation also created an inevitable penalty upon exports and encouragement to imports, and the adverse movement in the balance of trade led with equal inevitability to the imposition of clearings, either by the control country in self-defense or by the trade (creditor) partner. When, finally, international price and exchange-rate equilibrium was relegated to obscurity with advent of the Hitler regime, foreign trade would have shrunk to a *quantité négligeable* had not concealed devaluations been introduced — requiring in themselves tremendous additions to the control apparatus — or had not, sometimes in conjunction with incomplete devaluation, clearings and compensation been maintained and extended.

It is not to be supposed that a *quantité négligeable* of foreign trade represented the goal of exchange control in totalitarian Germany before the present war. "Autarchy" rather than "autarky," in the language of Professor Fisher,² was the end actually striven for — not absolute economic self-sufficiency within the German borders, but the creation of an international self-sufficient unit, dominated by the needs and aims of the German economy as conceived by its "leaders." Nevertheless, autarkic tendencies played an important rôle, not only because national self-sufficiency was an ideal of the ruling party embodied in the Second Four-Year Plan, but also because of the repercussions of exchange control itself and the workings of the so-called "active

1 Cf pp 3-6 above

2 A G B Fisher, *Economic Self-Sufficiency* (Oxford, 1939), pp 4, 17
Cf also *Economic Journal*, Vol 49 (March, 1939), pp 177-178

economic policy" (*aktive Konjunkturpolitik*).¹ Since this policy rested upon credit expansion without much regard to foreign price developments and since furthermore the old parity of the Mark was adhered to or only incompletely offset by *ad hoc* devaluations, the restriction upon exports, and in the long run upon imports, forced a measure of "autarky" as the cost of "autarchy."

To serve as the fulcrum of the gradually emerging "active economic policy," exchange control had piecemeal to be reconstructed and extended. But just as the turn from deflation to credit expansion required a certain interval (the nine months covered by the Papen and Schleicher governments), the subjugation of foreign trade to economic policy could not be compassed immediately. Remnants of the old liberal system could still be discerned, though with increasing difficulty, as late as the summer of 1934. The two sections which follow deal with the transitional phase of German exchange control from the beginning of the National Socialist state to the complete dominance of "active economic policy" in the Moratorium of July, 1934, and Schacht's "New Plan" of September, 1934.

A *Germany's Foreign Trade and Foreign Indebtedness under the Influence of the "Active Economic Policy," 1933-1934*

The notorious power of an overvalued currency unit to retard exports and accelerate imports made itself felt as soon as exchange control was well established in Germany. Under the influence of depression and the whole nexus of barriers to trade and payments, both exports and imports dwindled, but exports fell off faster. Having reached its peak in the capital-flight year of 1931 at 2,872,000,000 Reichsmarks, the favorable balance of trade diminished to 1,072,000,000 Reichsmarks in 1932, to 667,000,000 Reichsmarks in 1933, and gave place to an import surplus in 1934. But the effect of the artificial Mark parity comes into still clearer relief if we follow the course of the volume rather than the value of trade. By expressing exports and imports in these years in terms of the prices of 1929, we arrive at an approximation of changes

1. The interconnection of German exchange control and the "active economic policy" has been set forth in an illuminating fashion in Dr. Fritz Meyer's report to the International Studies Conference subsequently published in the *Weltwirtschaftliches Archiv*, Vol. 49, No. 1 (May, 1939), pp. 415-472. Other features of this report will be commented upon less favorably in a later connection.

GERMANY'S BALANCE OF TRADE AT ACTUAL PRICES AND AT PRICES OF 1929
(IN BILLION REICHSMARKS)

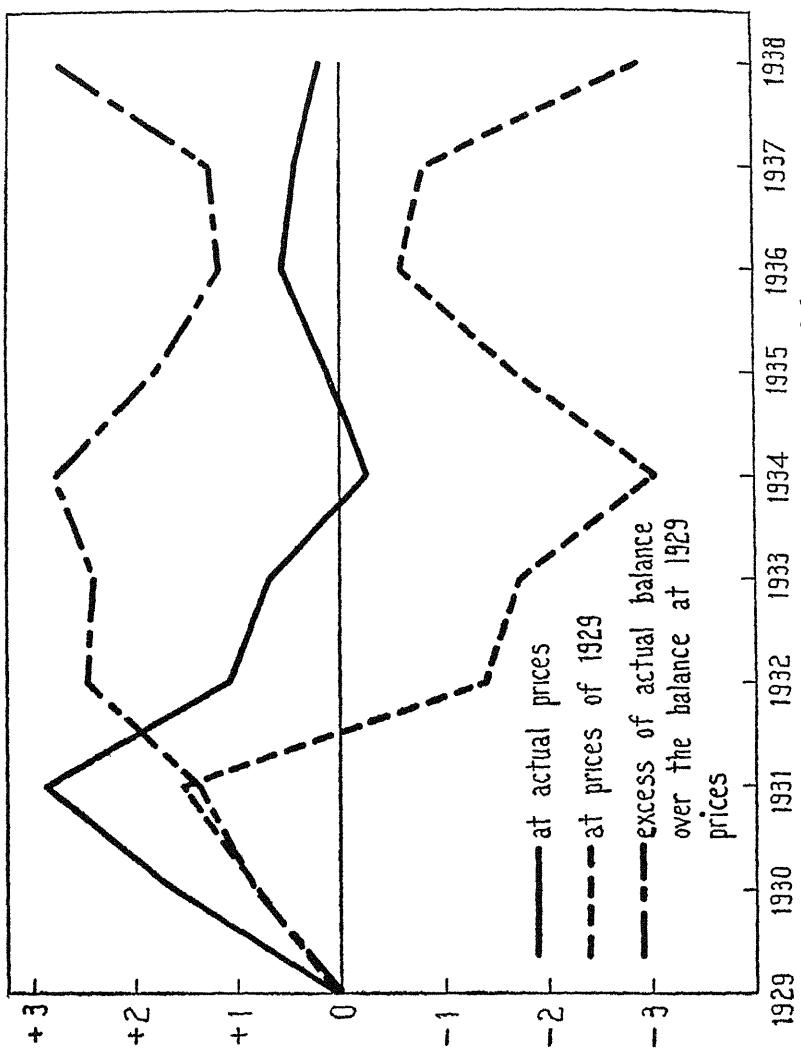


FIG. 21 * For data and sources, see p. 392 below

aside from those of price, i.e. in trade volume.¹ These figures show that, had prices remained unchanged, the export surplus would have been confined to 1930 and 1931, by 1932 there would have been an *import* surplus of 1,410,000,000 Reichsmarks by 1933, 1,740,000,000 Reichsmarks, and by 1932, 3,050 000,000 Reichsmarks.

That the actual export surpluses were much larger and lasted longer than the surpluses at 1929 prices is a circumstance for which Germany could thank a favorable turn in her terms of trade due to the well-known fact that during depressions the prices of raw materials decline faster than the prices of industrial products.² In other words, the advantageous development of the underlying terms of trade for Germany served to counteract to a striking degree the adverse effect of the overvalued Mark in international trade. Guillebaud puts the accomplishments of the National Socialist regime in the economic sphere in an unduly favorable light by mentioning only the deterioration of German terms of trade after 1932;³ the great extension of employment surmounted even this obstacle. Actually, as the following figures show, the terms of trade for Germany remained far above their pre-depression

THE TERMS OF INTERNATIONAL TRADE, 1929-1938*
(1929 = 100)

	England	Germany
1929	100 0	100 0
1930	106 1	108 2
1931	115 7	123 8
1932	115 5	144 4
1933	119 9	142 8
1934	118 8	135 9
1935	115 3	126 3
1936	112 6	122 0
1937	108 0	117 6
1938	114 7	128 8

* Computed from data in League of Nations Review of World Trade 1937 (Geneva 1938) pp 86-88

1 Cf. Figure 21 and the statistics on p. 392, below.

2 This may rest, as Harrod believes, upon an underlying secular tendency for demand for agricultural products to shrink relatively to more highly fabricated goods, and the intensification of this secular tendency by cyclical depression. Cf. R. F. Harrod, International Economics, revised ed. (Cambridge, 1939), pp. 52-54.

3 Guillebaud, op. cit., pp. 62, 100, 106, 149.

level throughout the whole course of depression and recovery, despite the downward drift in recovery years. Not only did the behavior of industrial relative to agricultural prices redound to Germany's benefit, but so far as concerns the terms of trade, the maintenance of the Mark parity also operated in this direction. Indeed, it may be stated quite summarily that, aside from the prevention of a flight from the currency, the chief motive of holding a monetary standard at an artificially high level is the securing of more favorable terms of trade than would be realized if the exchange rate fell to its equilibrium level. Compare the German terms with those of England, where the currency unit was devalued. The exports of both countries are preponderately industrial, and yet Germany through the high Mark rate enjoyed by far the greater advantage in terms of trade.

Whereas the gain through the artificial Mark entailed its cost in a drag upon export capacity, the advantage secured through the industry-agriculture price relationship represented a net gain. The latter fact rendered exchange control more tolerable, and permitted the continuance of allocating devisen by quotas without direct interference with imports. Throughout the year and a half from May, 1932, to February, 1934, the monthly quota was kept at 50 per cent of imports as of the base period June, 1930 to July, 1931, and since average monthly imports amounted to 58 per cent on approximately the same base,¹ the unsatisfied margin of demand for devisen does not appear to be large. Of course, the parallel movement of imports with the quotas was undoubtedly partly a consequence of the quotas themselves. But, on the other hand, foreign exporters showed their willingness to submit to substantial delays in payment, and this additional fact warrants the conclusion that, all in all, German importers of raw materials felt, but did not find intolerable, the pinch of exchange control.²

Because of the underlying deflation under Brüning, the favored position of a country with industrial exports, and the profits upon bond repatriations, Germany's favorable balance of trade was sufficient to permit fairly substantial repayments on the short-term foreign debts, and foreign devaluations made large contributions. The original Standstill agreement of September, 1931, embraced

¹ October, 1930 to September, 1931 Cf V z K , Vol 9, No 3, Part A, p 97

² Werner Fischer, Devisenclearing, No 5 in Schriftenreihe zum Devisenarchiv (Berlin, 1937), p 23

6,300,000,000 Reichsmarks, the reduction to 5,000,000,000 Reichsmarks at the Second Standstill in February, 1932, was mainly due to sterling devaluation but the further reduction to 4,100,000,000 Reichsmarks at the Third Standstill in February 1933 represented for the most part actual transfers. By the time of the next Standstill, in March, 1934 the sum had been reduced by 1,500,000,000 Reichsmarks, of which dollar devaluation accounted for 475,000,000 Reichsmarks.¹ Paralleling the marked reduction of Standstill debts, other short-term foreign debt categories dwindled by repayments and devaluations. The decrease of long-term debt, was much smaller and was almost entirely attributable to foreign currency devaluations.² Bond repatriations, while aiding the current balance of trade through the diversion of profit into export subsidy, did not bulk large relatively to the total of long-term indebtedness.³ But interest payments of 1,500,000,000 Reichsmarks were made during 1931, and an equal amount was paid over the two years 1932 and 1933, aside from service upon the Dawes and Young Loans, which brought the total for these two years to 2,000,000,000 Reichsmarks.⁴

The situation in the summer of 1933 represented the crucial episode in the history of German exchange control, for then if ever there were elements favorable to the gradual relaxation of the system, had the government desired it. Immediate abandonment would undoubtedly have been unwise in view of several circumstances. Dollar devaluation was in progress, and no one could foresee its ultimate effects in the international monetary situation. Economic recovery had begun in England and the Scandinavian countries, but another year had to elapse before it became apparent that the bottom had already been touched for Western Europe and America as a whole. Within Germany political tension

1 VzK, Vol 9, No 3, Part A, p 96

2 Thus the decrease from 10,300,000,000 to 7,400,000,000 Reichsmarks from February to September, 1933, was produced by dollar devaluation

3 Cf League of Nations, Balances of Payments 1937 (Geneva, 1938), p 110. Between November, 1931, and November, 1933, repatriations amounted, according to the German authorities, to 781,000,000 Reichsmarks, and "additional" exports to 549,000,000 Reichsmarks, cf. Economist, Vol 118, No 4721, p 348. The hesitancy of the authorities to reveal the extent of repatriations establishes a presumption for a somewhat higher figure, cf. Harris, op cit, p 58

4 League of Nations, Balances of Payments 1937, loc cit, and "Die Deutsche Zahlungsbilanz der Jahre 1924 bis 1933," Sonderhefte zu Wirtschaft und Statistik, No 14 (Berlin, 1934), p 20

remained high, the favorable balance of trade continued to shrink, and gold and devisen reserves of the Reichsbank fell from 1,100,000,000 Reichsmarks at the beginning of 1932 to 303,000,000 in June, 1933. And finally, the gap between the official and equilibrium values of the Mark was appalling.¹ On the other hand, as we have just seen, the service and amortization of foreign debts proceeded satisfactorily, and a marked improvement of the short-term debt situation, in particular, removed much of the psychological pressure which had accounted for the original introduction of exchange control. Capital flight was reduced to tolerable proportions, and illegal dealings in Marks at black market rates were being effectively suppressed. In short, exchange control during the first two years could be regarded, even by a liberal economist, as reasonably satisfactory.² Finally, the impact of sterling depreciation had been got over, and signs were not lacking of an approach to the end of cyclical depression. In a similar world *Konjunktur*, and with far less prospects than Germany's to induce a general movement in this direction, Austria had by the summer of 1933 already taken such decisive steps toward the liberation of international payments as to insure the eventual disappearance of exchange control, save for certain precautions against capital flight. This difference did of course exist, that Austria had followed a generally deflationary course, whereas since the autumn of 1932 German monetary policy had turned by gradual degrees to a reflationary basis. But the quantitative difference over a year could have been absorbed into a somewhat larger devaluation of the Mark.

To progress toward restoring free international payments, Germany would need to gauge the tempo of the *aktive Konjunkturpolitik* to international developments, but the preservation of an open and stable currency after devaluation would not necessarily involve a surrender of the expansionist work-creation program. Policies of this sort were being set afoot in other countries (outside the gold bloc), and in view of the later success of the National Socialist regime in forcing new credit and savings into investment and in avoiding conspicuously adverse price developments,³ there

1 The extent of the overvaluation of the Mark is the subject of investigation at a later juncture, cf. pp. 235-242, below.

2 Gottfried Haberler, *The Theory of International Trade* (London, 1936), p. 86.

3 There appears to be a consensus amongst Balogh, Guillebaud, and Poole, in monographs already cited, upon these points.

seems to be good reason for supposing that the rate of expansion in Germany could have kept abreast and with the formidable totalitarian apparatus might even have exceeded the pace of other countries To avoid a shock to public confidence, devaluation might well have followed the cautious and half-concealed course taken by Austria with respect to the Schilling, and thereafter the forcing of expansion would have to be watched at every juncture for untoward price developments, particularly in the segment of internationally traded commodities

To assess the reasons leading to the rejection of this course is not easy, since they were apparently compounded of more and less rational considerations In the first place, it was impossible to know in advance whether the powers of the state would be equal to carrying through a large-scale expansion of credit and production without considerable price inflation Exchange control would conceal — at least partly — an unsuccessful outcome of this character If direct price control and diversion of demand into producers' goods did not succeed completely the maintenance of a new and open currency would be conditioned by foreign recovery, and the National Socialist regime could not brook even this potential limitation Furthermore, the existing control over foreign exchange represented a powerful instrument in the hands of the regime, both in the domestic economy and in international political and economic relations The state made itself appear indispensable to prevent the Mark from collapsing Capital movements could be regulated to suit the current exigencies, and the character of exports and imports could be prescribed in detail to serve the ends of the state The dispensation of authority regarding supplies of essential raw materials presented itself as a convenient channel for rendering producers tractable in all matters Finally, the weapon of clearing and compensation could be turned against Germany's uncooperative neighbors and in favor of her allies Against all of these potential gains, the advantages of the international division of labor and financial cooperation probably seemed uncertain And it was even a proud part of the National Socialist philosophy to flout such aims as belonging to the moribund ideology of democracy

Schacht did not tire of repeating the truth that Germany's ability to pay her debts depended upon her favorable balance of

trade¹ While there was undoubtedly some justification for his thunderings against the creditor countries for their indisposition to import more heavily from Germany, this cannot conceal the fact that the "active economic policy" being carried out under the continued cover of exchange control actually prevented any substantial surplus of exports and the continuation of foreign debt service and repayments Under the existing overvaluation of the Mark, the favorable balance of trade had shrunk from 2,872,000,000 to 667,000,000 Reichsmarks from 1931 to 1933 It may be assumed rather safely that the government and Reichsbank watched the dwindling gold reserves with equanimity, as this provided the necessary pretext for unilateral action in reducing the foreign debt service

This action came on June 9, 1933, in a law which created the so-called Conversion Office and proclaimed a transfer moratorium for long- and medium-term debts For all such debts in foreign currencies, the service was to be paid into the Conversion Office, exception being made for the Standstill debts The creditor countries promptly retaliated by threatening to impose compulsory clearings and thereby forced a compromise Interest and amortization on the Dawes Loan and interest on the Young Loan were to be transferred in full, other coupons and revenues were to be transferred to 50 per cent at a rate of interest not to exceed four per cent, and for the remaining 50 per cent, interest-bearing scrip was to be issued, finally, Mark payments for amortization were to be blocked Marks, applicable to investment within Germany From October 1, 1933, dealings in scrip and registered Marks were centralized in the Golddiskontbank Since scrip was bought by its agent-banks at 50 per cent of face value, the procedure transferred effectively in devisen 75 per cent of the interest The re-purchasing banks sold scrip to the Golddiskontbank at 52½ per cent of face value, and the Golddiskontbank put the scrip at the disposal of exporters at 55 per cent What the exporter in turn could realize was computed on the formula $\frac{\text{loss from export} \times 100}{\text{discount on scrip}}$, amounting

at that time to 10–20 per cent of the invoices²

1 As, for example, in his address to the International Agricultural Conference at Bad Eilsen, August, 1934

2 Department of Overseas Trade, Economic Conditions in Germany, June, 1934 (London, 1934), p. 37, cf. also League of Nations, World Economic Survey 1933–1934 (Geneva, 1934), p. 206

The ingenious system by which repayment profits were turned into an export stimulant was one of the first instances of direct interference with foreign trade, for other exchange-control measures had pertained only to payments, which of course affect trade, but only indirectly. To obtain the benefit of scrip profit, the exporter had to prove that the export was "additional." This concept of "additional" exports was destined to become one of the main pillars in the structure of controlled trade. Somewhat paradoxically, the increase of "additional" exports attended a steady decline in total volume of exports, according to official estimates. "Additional" exports amounted to 100,000,000 Reichsmarks in 1932, 700,000,000 Reichsmarks in 1933, and 1,250,000,000 Reichsmarks in 1934, while the total exports at these years aggregated to 5,739,000,000, 4,871,000,000, and 4,167,000,000 Reichsmarks. From less than two per cent in 1932, "additional" exports increased to 14 per cent of total exports in 1933.¹

Inasmuch as "additional" exports may be regarded as resulting from an offset to the overvaluation of the Mark, and since such an offset was necessary for most exports, virtually all exports could be regarded as "additional" under the formal definition of the term. For practical purposes, however, several tests were applied. An export was recognized as "additional" when the foreign purchaser demanded that he be allowed to apply a certain amount of frozen Marks, owned by himself or someone whom he represented, to the payment of the bill. When it could be shown that the foreign prices were lower than the German price, or when the export was impossible without the aid of the scrip bonus, the export was considered "additional." Frequently the exporter was required to prove that his exports would be made higher absolutely than they had been in the particular category during the preceding year. As to the first tests mentioned, only exports in which Germany's comparative advantage was very great would, under the existing overvaluation of the Mark, fail to be classified as "additional" on any realistic basis. As for the last criterion, the shifting of exports from one firm's name to another through a profitable collusion, or the artificial concentration of exports in a shorter than usual period, would make them conform to the test without their being genuinely additional. Huhle says with complete justice that "despite the definitions, 'additional exports' defy all attempts at clarification of

1 Department of Overseas Trade, loc. cit., p. 36.

the concept "¹" In any event, the "additional" exports involved a procedure which entailed far-reaching official supervision of the whole export trade, and the very looseness of the concept proved to be an easy device for favoring certain exporters and discriminating against others

The inadequacy of "additional" exports to overcome the handicap of the overvalued Mark led to the peculiar phenomenon of attempts to supplement the profit motive by energetic appeals to the German people's "will to export"² This intrusion of Nietzschean metaphysics should be noted, for it became characteristic of the German economy after February, 1933

The compromise with foreign creditors after the June 9 transfer moratorium was altered shortly afterward with respect to Switzerland and Holland. Because of their excess of imports from Germany and their debtor position on current account, these countries succeeded in their insistence upon full payment on interest coupons out of the proceeds of German "additional" exports. Furthermore, certain of their own exports to Germany and the German tourist traffic were to be paid for in the same way, providing an automatic expansion of their receipts as "additional" exports were fostered. The connections between Germany's solution of the debt problem and trade bilateralism came through such channels to be more and more intimate.

In December, 1933, Germany reduced the debt service in free exchange from 50 per cent to 30 per cent. Protests of the creditors, who stressed a recent improvement in Reichsbank reserves,³ led to the purchase of scrip by the Golddiskontbank at 67 per cent instead of 50 per cent, and this signified a payment of 76.9 per cent instead of 75 per cent of interest charges.⁴ But the first six months of 1934 saw so heavy a fall in Reichsbank *devisen* reserves that they did not exceed 2.5 per cent of the note circulation. The shrinkage was made more spectacular by the Bank itself, which hurriedly repaid certain loans. After futile discussions with creditor representatives

1. Fritz Huhle, "Das Kompensationsgeschäft in Rahmen der deutschen Handelspolitik seit der Wirtschaftskrise," *Jahrbücher für Nationalökonomie und Statistik*, Vol. 145, p. 199.

2. Cf. V z K., Vol. 9, No. 1, Part A, p. 31.

3. As a result of a law against "economic treason," about 120,000,000 Reichsmarks in gold and *devisen* were surrendered by the public. Cf. Müller, *op. cit.*, p. 260.

4. Müller, *op. cit.*, p. 228.

in the spring of 1934 the government proceeded on July 1 to a complete transfer moratorium, interest payments thenceforth were to be met by the issue of three per cent Funding Bonds. President Schacht offered a lengthy apology for this step — the loss of German colonies after the War, and trade difficulties caused by tariffs, quotas, and foreign devaluations.¹ He stressed Germany's efforts to pay her debts, but passed over in silence the fact that foreign devaluations and the profitable repatriation of bonds due to the imposition of exchange control accounted for a substantial part of the actually recorded reduction of debts.

B *The German Clearings System and the IMPASSE of 1934*

The final step taken by Germany in July, 1934 to make the Moratorium absolute encountered less complacency on the part of creditors than had preceding limitations on payments. In England, Parliament hurriedly passed the "Debts Clearing Office and Import Restriction Bill" and provided for a 20 per cent *ad valorem* duty on imports from Germany. France, Holland, and Switzerland likewise threatened with compulsory clearings, and since all of these countries, unlike the United States had unfavorable trade balances with Germany and consequently owed her on current account, they managed to secure the earmarking of part of the German export surplus for the debt service. This development in the summer of 1934 led to the contention, which has become common in German writings on exchange control that Germany's creditors forced the system of clearings upon her. Was this actually the case?

The first clearing agreements were concluded by Germany in the spring of 1932. As Fischer very properly says, Germany considered these clearings to be the best available solution of two problems (1) "How is it possible for Germany to thaw out her frozen commercial credits in exchange-control countries?" (2) How is it possible for Germany to maintain her favorable balance of trade with free-payments countries?² The clearing system was already two years old before the Western European creditor nations threatened to impose *Zwangsclearing*. Previous to this move, which forms the basis of the German pose as the luckless

1 Oesterreichischer Volkswirt, Vol. 26 (June 23, 1934), p. 839

2 Werner Fischer, Devisenclearing, p. 19

victim of rapacious creditors,¹ Germany had indeed entered into clearing arrangements providing debt-liquidation schedules in favor of the western countries, if the active force in this matter was the creditors' insistence on a certain amount of payment, it was nevertheless a subject of negotiation and voluntary agreement. Where Germany herself occupied the position of creditor, as in her relations with Eastern European countries, she did not hesitate to insist upon amortization clauses in the clearings.

Indeed, the very *first* of Germany's clearing agreements had precisely this purpose "Agricultural countries which became 'devisen insolvent' should be given the opportunity to discharge their commercial debts gradually through increasing their exports to Germany," it was maintained.² The German-Hungarian clearing agreement of 1932 represents a rigorous imposition of bilateralism to secure the release of German credits tied up by a foreign exchange control. It was exceptionally severe upon contemporary standards — though not upon standards which later came to be common — through its involving government instead of central-bank legislation, and through its making the clearing compulsory. It furthermore imposed a clearing rate so unfavorable to Hungarian importers³ that Germany's favorable balance declined from 11,000,-000 Reichsmarks in 1932 to 3,900,000 Reichsmarks in 1933, and the Reichsbank felt compelled to make advances to exporters on the old commercial debts, which it was the ostensible purpose of the clearing to liquidate. The high Mark rate had balked the effort.

In 1932 Germany concluded clearing agreements with other exchange-control countries such as Bulgaria, Estonia, Greece, Jugoslavia, and Rumania. These differed from the agreement with Hungary in that they were negotiated between the central banks and allowed transactions outside the clearing. But their purpose was again to secure amortizations on Germany's behalf, and they provided no margin of payments for her clearing partners in free devisen.

Germany also instituted non-compulsory clearings during the

1 Even one English writer seems to have capitulated to this view, cf. Guillebaud, *op cit.*, p. 65.

2 *V z K.*, Vol. 12, No. 3 (N. S.), p. 315.

3 Cf. *Währung und Wirtschaft*, February 1933, p. 33. The pengo had depreciated by about 25 per cent, the Mark considerably less, but the clearing rate was the old parity.

second half of 1932 and the early part of 1933 with a number of Western European free-payment countries. The avowed purpose of these clearings was "to render possible additional exports and imports beyond the scope of the *devisen* quotas,"¹ but it is difficult to reconcile this with the position taken by the authorities in other connections that the *devisen* quotas were adequate, at least until the early months of 1934.² To be sure, the allocation scheme had been amended subsequently to its introduction to set a limit, not only upon the total foreign-exchange purchases for each importer as a percentage of his 1930–1931 requirements, but also upon the share of this total which he could apply to imports from individual countries. Shifts in the channels of trade might therefore engender scarcities of *devisen* for imports from particular countries, even if the total generally speaking were adequate. But it seems probable also that clearings with non exchange-control countries were prompted, at least in part, by a growing pressure of imports on the quotas. It was also said that a fear of foreign retaliations against German exchange control moved Germany to initiate clearings herself in order to be able to propose terms acceptable to herself. But against what could the supposed foreign retaliations be directed, if not to secure liquidation of important arrears on current account accumulating because of the inadequacy of *devisen* allocations? Retaliations to force payment on long-term debts could not have played a rôle before the transfer moratorium of June, 1933. Even before the practice of direct quantitative interference with imports was openly avowed in Schacht's "New Plan," it undoubtedly existed in fact.

Agreements of the sort under consideration, usually called "Swedish Agreements" or "Swedish Payment-Agreements,"³ had the common features that they established a clearing procedure for trade in excess of amounts which the exchange-control country could carry on by means of *devisen*, and that they laid down a

1 Belgium-Luxemburg, Finland, France, Holland, Italy, Norway, Portugal, Spain, Sweden, and Switzerland, cf. Fischer, *op cit.*, p. 24

2 Fischer, *op cit.*, p. 21

3 Cf. pp. 183–184 above

4 The term "payment agreement" has come in the course of time to refer less commonly to arrangements of the "Swedish" type, and more commonly to the centralization of all payments in government offices in the partner countries with the purpose of allocating export proceeds upon the basis of an agreement between the two countries, the settlement of balances being made, however, entirely in free *devisen*. Cf. p. 15 above.

certain fixed ratio of exports and imports so as to provide a margin out of which the exchange-control country discharged its debts. The development of "Swedish Agreements" reveals two more or less distinct periods. The first extends from their introduction to the late spring of 1933, during which time they worked satisfactorily, perhaps because they played no very important rôle. Temporary increases in German imports were cared for through the clearing (or "Swedish") account, and this relieved the *devisen* allocations from inequalities in demand. The second period dates from the middle of 1933, when the popularity of "Swedish Agreements" increased tremendously, but developments which we must now examine proved that they were no solution of Germany's difficulties with her foreign trade.

The second half-year 1933 and the first half-year 1934 witnessed a rapid growth in the disparity of German and foreign prices when calculated over the rate of exchange, as in Figure 20 (p. 16). In April, 1933, the lowest point of depression in Germany was passed,¹ and the effects of credit expansion became apparent in advances of the wholesale and sensitive price indices² while prices abroad still continued in general to decline. Not only from this source but also from the contemporary devaluation of the dollar, the Mark came to a more pronounced overvaluation, with an intensifying of the import premium and export penalty. Exchange control had to be tightened. Travellers had formerly been permitted an allowance of 200 Reichsmarks, but now were limited to 50 Reichsmarks, emigrés had formerly been given disposition over 10,000 Reichsmarks, but now were cut to 2,000 Reichsmarks. Importers' *devisen* quotas fell to 45 per cent in March, 1934, and then by successive stages to 35 per cent in April, 25 per cent in May, 20 per cent in June, 10 per cent in July, and five per cent in August.³ As early as June, furthermore, the Reichsbank limited its actual *devisen* allocations within the quota to its daily *devisen* receipts, as a result foreign sellers or German importers were confronted with complete uncertainty as to when payment would be forthcoming. The quotas had lost any practical importance and the last remnant of unregulated trade had disappeared.

1 League of Nations, *World Economic Survey 1934-1935* (Geneva, 1935), p. 44.

2 Cf. p. 378 below.

3 Fritz Huhle, *op. cit.*, p. 187.

The German economic authorities found themselves faced with a veritable dilemma on the one hand, the overvalued Mark by its indiscriminate encouragement to import had actually turned the large export surpluses of previous years into an import surplus without visible wherewithal for payment, on the other hand, the industrial expansion program required an increase of imported raw materials for its nurture. Against a 17 per cent advance of industrial production in 1934 over 1931, imports had fallen in value by one-third. If we apply 1928 prices to the import figures to secure an approximation of changes in their volume, the decline over these years shrinks to less than five per cent, and there is a further mitigation through the undoubtedly shift from lighter and more highly fabricated goods to the heavier and cheaper raw materials.¹ Even so, if the volume of imports merely remained stationary, it would impose severe limits upon induced recovery and the beginnings of re-armament.

The strategy of the government in these straits, which later became the lodestone of economic policy, was to divert purchasing power from consumers' goods into capital goods, i.e. to limit consumption demand and deflect the expanding volume of money incomes into investment, and thus create employment without much price inflation, at least in those segments where it would strike the public's attention.² The attack upon imports of consumers' goods was made indirectly through limiting profits on sales to consumers and directly through limiting imports. Under the first method came a decree in April, 1934, forbidding higher prices upon raw materials in the textile and leather industries than had prevailed in March. A general act on May 16 prohibited agreements as to minimum prices, profit margins, and rebates on the "products of daily need", shortly afterward the prohibition was extended to all goods.³ To cope with the wave of imports oriented toward consumption, the government placed textile raw-material imports under Control Boards (*Überwachungsstellen*) by the law of March 22, 1934, and later, with an eye to the use made of certain imports, it established similar Boards for non-ferrous metals, cowhides, and rubber. This measure is noteworthy as the

1 V z K, Vol. 8, No. 3, Part A, p. 182.

2 Cf. Poole, op. cit., pp. 90, 117, 141, 161, 183, 234; Bologh, op. cit., pp. 470-473, 483-484, 491.

3 Reichskreditgesellschaft, Germany's Economic Situation at the Turn of 1934-1935 (Berlin, 1935), p. 36.

first openly avowed *qualitative* interference with imports, since until this time exchange control ostensibly pertained merely to quantity of imports as a whole. These measures decreased imports of raw materials by 23 per cent in the period April to August,¹ and produced repercussions upon world markets, such as the five per cent fall in the price of wool.²

The success of the government was short-lived, however. For one thing, the reduction of devisen quotas pushed the bulk of trade with Western Europe into channels covered by "Swedish Agreements," where imports were permitted in excess of amounts purchased with devisen. Payments into these accounts mounted quickly from 68,000,000 Reichsmarks in March, to 93,000,000 Reichsmarks in June, and 130,000,000 Reichsmarks in July, 1934.³ The operation of free economic forces also brought about effective evasions of the prohibitions laid upon raw-material imports while cotton imports dropped, they were simply replaced by imports of yarn from England, and while raw-material imports decreased from August to September by 21 per cent, imports of manufactured goods rose by 19 per cent. But it was chiefly the breach in Germany's import barriers through the "Swedish Agreements" which turned her balance of trade between 1933 and 1934 from active to passive, as shown in Figure 22. An attempt to prevent the abuse of these clearings for imports actually originating in other countries by requiring a certificate of origin (the so-called "Holland Clause") broke down under evasions. The very countries which had usually accounted for Germany's strongest export balances showed the largest shrinkage. From a favorable balance of 667,000,000 Reichsmarks in 1933, Germany experienced a turn to an unfavorable balance of 284,000,000 Reichsmarks in 1934, and of the total

GERMAN TRADE WITH COUNTRIES UNDER "SWEDISH AGREEMENTS"**
(in million Reichsmarks)

	German Imports	German Exports	German Balance
1933	1,117 2	2,298 9	1,181 7
1934	1,266 6	1,978 5	711 9

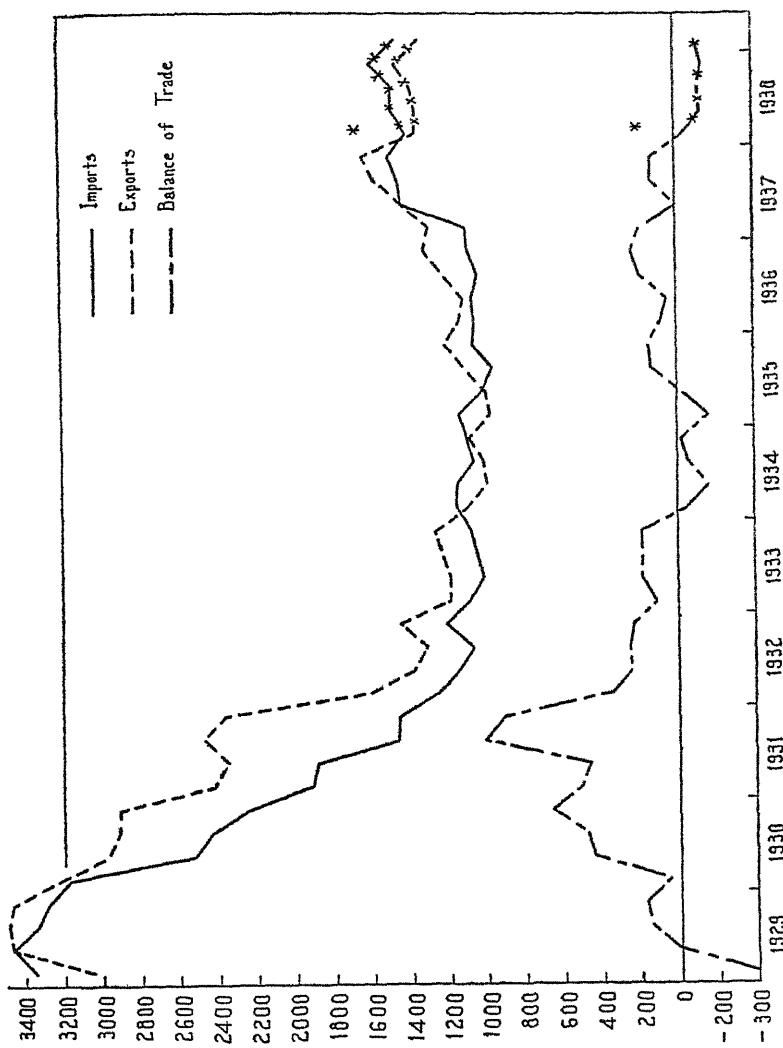
* Fischer op. cit., pp. 24-25.

1 VzK, Vol. 9, No. 3, Part A, p. 97.

2 League of Nations, World Economic Survey 1933-1934 (Geneva, 1935), p. 314.

3 VzK, loc. cit., p. 98.

GERMANY'S FOREIGN TRADE, 1929-1939 Imports, Exports, and Balance of Trade*
 (Quarterly in Million Reichsmarks)



* From the second quarter of 1938, the figures pertain to Greater Germany.

† For data and sources, see p. 380 below.

reduction of 951,000,000 Reichsmarks in the balance, trade under "Swedish Agreements" accounted for a reduction of 470,000,000 Reichsmarks

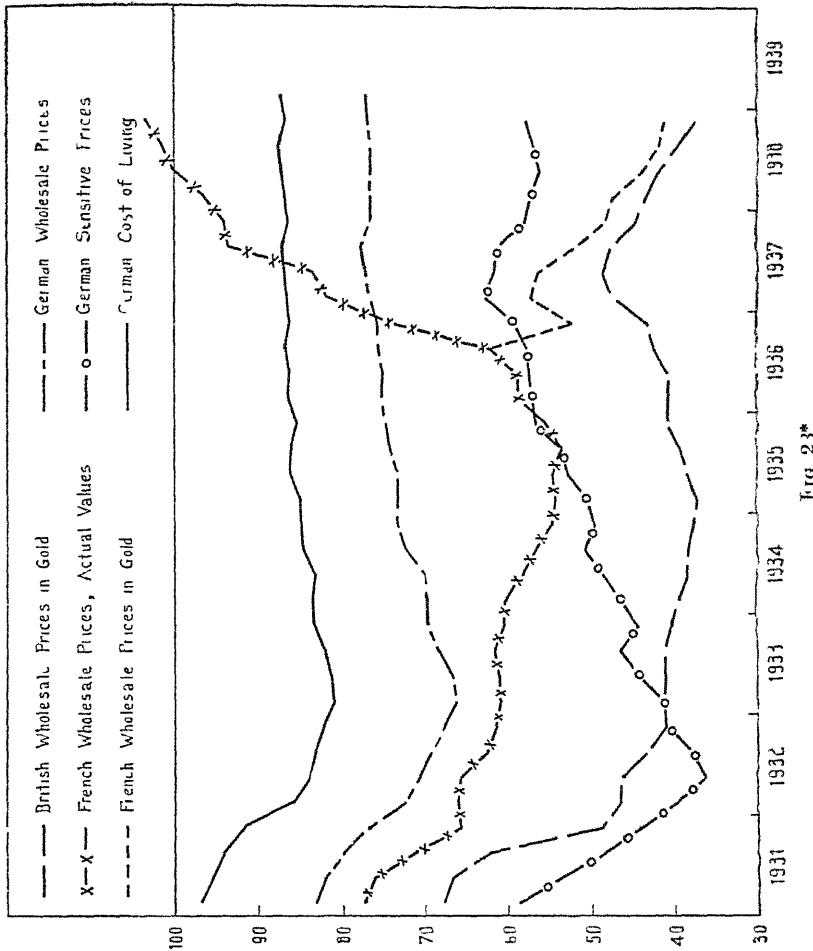
Other circumstances beside the "Swedish Agreements" contributed to this deterioration of Germany's trade balance. It is scarcely to be supposed that the formalities attending each export operation could have had anything but a dampening influence, even if the sale was made to free-payment countries. Moreover, foreign exporters frequently disdained to avail themselves of the "Swedish" clearing accounts, and instead delivered goods on credit in the hope — later proven to be fatuous — that payment would shortly be made anyway. The result was a mounting accumulation of sums owed to foreign countries in German clearing accounts. After the English-German clearing agreement went into effect on August 20, 1934, British exporters betrayed a reluctance to utilize the payment mechanism, with the result that *Sondermark* accumulated in Berlin to the agreed limit of 5,000,000 Reichsmarks, and mounted thereafter in a special interim account to treble this sum. In August, 1934, exporters in Lancashire stopped sales to Germany completely. By this time, German clearing debts amounted in total to 450,000,000 Reichsmarks, or half again the magnitude of her 1934 trade deficit.¹

This accumulation of commercial debt *per se* could scarcely have disturbed a government which shortly before had virtually defaulted upon a debt of 7,000,000,000 Reichsmarks. But it did signalize an *impasse* for German trade. Schacht expressed the matter thus: "The accumulation of debts does not press upon us as far as concerns foreign exchange, but it is likely to produce unfavorable psychological effects."² Amongst these "psychological effects" must be counted retaliatory measures such as the decision of the Lancashire cotton-textile exporters. But the most disquieting "psychological" factor was the simple calculus of relative prices, as may be seen in Figure 23. While German wholesale prices rose from 66 per cent to 73 per cent (1925–1927 = 100) and sensitive prices from 41 per cent to 50 per cent during 1933 and 1934, British wholesale prices in gold declined over the same years from 41 per

1 Cf. *Economist*, Vol. 119, p. 880, ibid., Vol. 133, p. 487, League of Nations, *World Economic Survey 1934–1935* (Geneva, 1935), p. 22.

2 Ernst Wagemann, *Zwischenbilanz der Krisenpolitik* (Berlin, 1935), p. 73.

BRITISH, FRENCH, AND GERMAN PRICES
(1925-1927=100)



* For data and sources, see p. 378 below

cent to 38 per cent, and French wholesale prices fell from 61 per cent to 55 per cent¹

The spread of bilateralism in German trade during 1933 and 1934, with which we have been concerned in this section, can by no means be represented as the consequence of the malevolence of Germany's creditors. The first clearing agreement and all of those pertaining to Germany's relations with Eastern Europe were imposed by Germany in order to afford security to her own creditor interests. Compulsory clearings were not threatened by the western creditor nations until Germany resorted to transfer moratorium. It is not to be gainsaid that the resort to import quotas, tariffs, and other protectionist devices had rendered Germany's lot as a debtor a hard one. But the reduction of her debt by foreign devaluation, the adjustment of interest and amortization, and the repayments actually made, had gone far toward offsetting these handicaps by 1933. The crucial determinant which fastened exchange control and bilateralism in trade upon the German economy was the "active economic policy." If it be said that this was a heroic program to lift Germany out of the slough of depression and unemployment, it must also be said that it delivered the *coup de grâce* to Germany's reputation as the "well intentioned debtor," and to the prospect of Germany and most of her neighbors for resuming normal economic intercourse within the visible future.

1. The divergences of prices were more striking for agricultural commodities, though the influence of exchange control was submerged in all sorts of protectionist devices. Prices in the following table are expressed in Reichsmarks per Kilogram, except for eggs, for which the basis is 100 by count, data from Reichskreditgesellschaft, Germany's Economic Development during the First Half of 1936, p. 72.

Commodity	Germany	World Market	Commodity	Germany	World Market
Wheat	20 55	10 41	Pigs	96 00	28 37
Rye	16 55	6 58	Butter	260 00	121 77
Oats	14 88	5 29	Lard	181 00	66 86
Fodder			Eggs (per 100)	11 50	4 97
Barley	15 45	8 17			
Maize (Plata)	15 50	5 84	Sugar	44 00	9 17
Cattle	82 00	23 87			

Cf also *Economist*, Vol. 120, p. 14

EXCHANGE CONTROL AS A TOTALITARIAN INSTITUTION

A Schacht's "New Plan" and the Reorganization of Bilateral Trade

(1) The Introduction of the Plan Although it would be impossible to regard the Schacht Plan as a new system of exchange control, it did involve the general adaptation of the system both within Germany and in international payments to the new order of completely controlled trade Intricate technical details lie somewhat afield of our interests, but we should examine the general scheme as it appealed inside the country and in clearing, payment agreements, compensation, and "Aski" arrangements

It was freely admitted in Germany, when in the late summer of 1934 the "devisen deficit" mounted to 700,000,000 Reichsmarks, that the quota system of allocating foreign exchange had failed abysmally¹ In September, Reichsbank President Schacht announced a system which he labelled the "New Plan" subsequently enacted by decree² The essential principle was that no importer could obtain an allocation of foreign exchange from the Reichsbank unless, prior to the importation, he secured a "devisen certificate" issued by special Control Boards³ Several months earlier, as we have seen, several Control Boards⁴ had been established, but now they were increased to twenty-five extending over all imports They had as a first duty the determination of the desirability of imports, allowable prices, and methods of payment, they had furthermore to detect and reject import applications in which there were hidden premia, and they endeavored to reduce imports necessitating free-devisen payment The Control Boards issued four types of devisen certificates according as the import involved

(a) cash payments, made chiefly for imports for further fabrication and re-export,

1 V z K , Vol 9, No 3, Part A, p 97, Österreichischer Volkswirt, September 15, 1934

2 R E 1/34 Ue St , September 19, 1934 In references of this sort the numerator represents the current number and the denominator the year of the Runderlass (R E) issued by the Überwachungsstelle (Ue St)

3 It was not until June 24, 1935, that importation without a devisen certificate was prohibited, initially only the allocation of devisen required certificates Cf Reichskreditgesellschaft, Germany's Economic Situation at the Turn of 1935-1936 (Berlin, 1936), p 60

4 Cf p 205 above Between the introduction of the first Boards on March 22 and the adoption of the New Plan, their number had been gradually increased to eleven

(b) acceptance credits which would prospectively be renewable, used only in cases of especial urgency,

(c) normal commercial credits, for which the Reichsbank agreed to supply devisen after the lapse of the ordinary commercial "terms" for paying,

(d) clearing and payment-agreement payment

The inclusion of the fourth category prevented the shifting to these payment devices of imports rejected as undesirable and ineligible for devisen allocation. The scheme embraced all payment possibilities with the one exception of "Aski" Marks, which could be used without previous application to a Control Board. On the side of exports, the New Plan did not contemplate direct control, it required only an export declaration after the shipment. Export prohibition was imposed upon certain raw materials, however, the "additional exports" were still subject to the requirement of *ad hoc* permissions in every case, and there could, of course, be no doubt as to the indirect repercussions of import control upon exports.

Neither the Control Board apparatus nor the regulation permitting discrimination between import categories represented innovations, but the far-reaching extent and objectives of the New Plan bespoke a new philosophy of exchange control. The objectives may be summarized as

(a) the reduction of imports of finished and half-finished goods, the reduction of exports of raw materials, concentration upon exports of finished goods,

(b) the reduction of imports from European industrial countries, the increase of exports to overseas countries supplying raw materials — countries with which Germany had always had unfavorable balances of trade,

(c) the restoration of a favorable balance of trade. Thus the New Plan meant a change in the composition of trade so as to favor employment (it was believed) within Germany and to effect this change bilateral agreements — wherein governments dictate the sphere and character of exchange — proved to be a formidable machine. Bilateral trade under this new conception required a recasting of the clearings

(2) The Western European Clearings. Even before the enactment of the New Plan, as we have seen, difficulties encountered with the "Swedish Agreements" were incompatible with the New Plan for a more fundamental reason than this loophole control could not extend to the *character* of imports unless *all* trade with a clearing partner was canalized in these accounts. Frequently, in order to complete control, the clearings embraced

not only commodity trades but also amortization and interest, commissions, tourist expenditures, and the like. The creditor countries usually forced an earmarking of a part of the German export surplus for debt service, but pressure was exerted by creditors for the incorporation of such clauses and not for the conclusion of clearings *per se*. During the summer and early autumn of 1934 Germany denounced all the "Swedish Agreements," except for Spain and Portugal. The most important of the new clearings related to Belgium, France, Holland, Switzerland, and the United Kingdom.¹

The agreement regarding international payments, reached on November 1, 1934, between England and Germany has been

1 In the German-Belgian agreement (September 5, 1934) a ratio of 100 62 5 was established between exports to and imports from Belgium. Three accounts were set up in Belgium:

- A — for payments of German imports from that country,
- B — for the debt service, and
- C — for the free disposal of the Reichsbank.

The interest of Dawes and Young Loans was to be paid in full, 4½ per cent interest was paid on other Belgian loans, where dividends of 4½ per cent or less were declared the full amount was paid, but only one half of the excess over 4½ per cent. (Cf. Kurt Schneider, *Der Welthandel im Clearingverkehr* [Berlin, 1937], p. 12.)

In the French-German clearing agreement (July 28, 1934), 15.75 per cent of the payments of French importers for German goods was to be paid for interest on the "Reich Loans" and other German debts.

The agreement with Holland was reached after this country had applied compulsory clearing in order, first, to collect a clearing balance of 170,000,000 Reichsmarks accumulated against Germany under the "Swedish Agreement," and second, to secure the service of the Dawes and Young Loans and the Stand still Credits. (Fabricius Helmut, "Das deutsch niederländische Verrechnungsabkommen," *Devisenarchiv*, Vol. 2, No. 5, columns 121-28.)

This agreement, entered into on September 21, 1934, lasted for two months, until denounced by Holland on December 12, 1934. (Schneider, op. cit., p. 56.)

The new agreement provided for 3½ per cent interest payments on Dawes and Young Loans and other loans, amounts in excess of 3½ per cent were to be paid, to the extent of two per cent in blocked Marks, four per cent conversion bonds, or Dawes or Young Marks. Of the export proceeds, 18 per cent was to be used for paying off the frozen commercial debts from the "Swedish Agreement," a process which required almost two and a half years. (Schneider, op. cit., p. 62.)

The Swiss agreement went into operation on July 26, 1934. Tourist traffic was linked with German coal exports to Switzerland. There were frequent revisions later as to the division of the export proceeds, the amounts set up for payments to financial creditors, the amount of Swiss exports to Germany, incidental costs, and devisen put at the free disposal of the Reichsbank.

praised so much on the German side — it was said to show the impress of “English realism,” for example¹ — that it merits at least passing attention. By the terms of the agreement, German exports were to bear to English exports a relation of 100:55, and the proceeds of German exports were to apply to current imports and to amortization of commercial and long-term obligations in predetermined proportions. So far there was nothing distinctive over the ordinary clearing arrangement. As in most of the clearings, furthermore, transit trade was excluded. But in place of settlement by offset of clearing balances, payments were made in free devisen, and this circumstance gave rise to the designation of “payment agreement” instead simply of “clearing.” Was this difference fundamental, and did it justify the enthusiasm betrayed in German comments upon the scheme?² It does not require an excursion into technical details of the agreement³ to reveal why the answer is negative. Free-devisen payment could mean very little when the rate of exchange had been immobilized against the ordinary forces of supply and demand, here the old Mark parity still applied and still operated, of course, to stimulate Germany’s imports and penalize her exports. The prospect of “continuous settlement in free devisen” was bound to prove illusory. For that portion of Anglo-German trade which did happen to “balance off,” the receipt and subsequent disbursement of its value in devisen gave Germany no advantage over cleared accounts under a clearing arrangement. No devisen accrued to Germany for that part of her favorable balance earmarked for liquidating old clearing debts or funded obligations. If the balance still left a sum owing to Germany,

1 Fischer, *op. cit.*, p. 31.

2 E.g. *Deutsche Bergwerks-Zeitung*, January 30, 1937; Fischer, *loc. cit.*, *Neue Zürcher Zeitung*, September 19, 1936.

3 Fifty-five per cent of devisen resulting from German exports to England in any one month was earmarked for imports from Germany in the second month. (This percentage excluded German sales to England against blocked Marks, “Aski,” and compensation, cf. Schneider, *op. cit.*, p. 35.) Interest on the Dawes and Young Loans was paid in full, but the service of other loans was covered only by four per cent (not three per cent, as provided in the transfer moratorium). Funding Bonds. The Reichsbank agreed to pay 400,000 Reichsmarks initially against the existing debt, variously estimated at 3,800,000 and 5,000,000 Reichsmarks, arising from “Swedish agreement” and Sondermark clearings in the past, and to devote 10 per cent of German export proceeds to this purpose in the next twelve months. (Cf. *Oesterreichischer Volkswirt*, Vol. 27, p. 106.) Beyond such stipulated applications there remained a considerable margin of devisen for the free disposal of the Reichsbank.

devisen were indeed to be available, though such a clause as this appeared in certain clearing agreements and scarcely constituted a new order of things. But with the Mark overvalued as it was in comparison with sterling the prospects were no more brilliant for such a free balance under a payment agreement than under clearings, unless the authorities intervened more promptly to force the 100:55 German-English export ratio by direct action than they might have done under clearings. This proved to be the case. Whereas the German authorities were originally supposed to grant import certificates freely for English wares, only two months elapsed before sharp restrictions had to be introduced, and this came to be a matter of frequent occurrence.¹ The underlying effect of the Mark rate to pile up a one-sided balance in the opposite direction from that contemplated in the agreement was only offset by direct limitations, and the settlement of accounts in free devisen fell to the order of an insignificant technical detail. The relative amicability marking negotiations regarding these limitations may at bottom have occasioned the favorable response in Germany, but the enthusiasm for payment agreements *per se* seems to have rested upon delusion, as even one German writer intimates.² Payment agreements did indeed affect technical simplification, which was ardently desired. The imposition of the New Plan had necessitated the erection of a Clearing Office in October, 1934, as a subsidiary of the Reichsbank, and the detailed regulation of imports entailed further extensions of the bureaucratic machinery and the "immense war of forms-to-be-filled-out."³ The burden of these formalities weighed heavily, not only upon the German importer but also upon the foreign seller. Under previous clearing agreements, the German importer had occasionally been "permitted," in the unconsciously ironical official language,⁴ to carry through these onerous procedures for his foreign trade partner. This "permis-

1 Reichskreditgesellschaft, Germany's Economic Development during the First Half of the Year 1935 (Berlin, 1935), p. 57; Department of Overseas Trade, Economic Conditions in Germany to March, 1936 (London, 1936), pp. 173-174.

2 H. Schumacher, "Germany's Present Currency System, its Development and its Reform" in A. D. Gayer (ed.), The Lessons of Monetary Experience (New York, 1937), p. 221.

3 Bernhard Bennings, "Der Neue Plan und die Neuordnung der deutschen Außenwirtschaft," Jahrbücher für Nationalökonomie und Statistik, Vol. 142, p. 43.

4 Wagemann, op. cit., p. 72.

sion" came to be rather generally incorporated into the payment agreements, and since a disburdening of the foreign trader must have aided German exports and imports at least slightly, there was rational explanation, however tenuous, for the popular vogue of the agreements. Furthermore, the frequent interference of authorities to keep the balances at the stipulated ratios prevented the piling up of clearing balances, always distasteful to creditors, including German creditors. Aside from these considerations, the German business community battened upon delusion if it imagined that the mere employment of *devisen* was a step toward free payments.

Nor does it seem possible to interpret the supplanting of clearings by payment agreements, first for England and subsequently for Belgium and France,¹ as betokening any weakening from the policy of bilateralism in official quarters. Nor did the maledictions heaped upon the clearing system by Schacht, who proclaimed it to be "atrocious,"² and by the German journalists and pamphleteers interfere with a vigorous prosecution of the program to expand German trade by clearings, compensation, and other bilateral devices. In the course of a few years it ceased to be fashionable to depiccate these methods of trade, and instead the Economic Minister urged the world "to look for the basis of international currency stabilization in a sensible clearing system" in which, as he justly observed, "the Germans have had more experience than anybody else in the world."³ And at the same time a representative of the fraternity of economists in Germany volunteered the suggestion that bilateralism should be regarded, not as a counsel of desperation, but rather as the modern and really adequate system of international trade and payments.⁴ Meanwhile, as was to be expected, German economic missions worked assiduously toward the extension of clearings and compensation to regions not already covered by bilateral agreements.

(3) Clearings and Compensation with South America and Southeastern Europe. As for the South American countries, clear-

¹ The Belgian payment agreement was concluded on August 1, 1935, and the French on August 1, 1937, the latter after two years required for the liquidation of arrears on the old clearings.

² *I e scheusslich*, cf. address of Schacht at Leipzig on March 4, 1935, *Economist*, Vol. 120, p. 526.

³ Address of Walter Funk, *New York Times*, March 7, 1939.

⁴ Meyer, *op cit*, *passim*.

ing agreements were concluded, for the most part shortly after the introduction of the New Plan, with Argentina, Brazil, Chile, Colombia, and Uruguay.¹ There seems to have been a desire on the German side to compass two mutually exclusive ends — the enforcement of repayments on outstanding obligations to Germany and the expansion of German exports. The attenuation of the traditional German export balance with Western Europe led to an export drive on South America, but the fact that Germany had ordinarily had a strong import balance from these latter countries should scarcely have led to the expectation of much success. Resort was had in Germany's Latin American trade to the "Aski" device, presently to be considered.

Commercial relations with Southeastern Europe proceeded under both clearings and compensation. These clearings reveal quite clearly the tendencies of costs under bilateral trade and are reserved for separate analysis later. Compensation dealings with the Southeast assumed some importance at an early stage of German exchange control. In 1932 the Reemtsma cigarette firm bought 250,000,000 Leva of tobacco from Bulgaria through the intermediation of the Bulgarian National Bank against the cancellation of 187,500,000 Leva of frozen German claims and the export of German goods for the balance. Similar arrangements were entered into during the same year with the Greek and Turkish governments. Thereafter the opening of clearings largely supplanted compensations with these countries. The barter device served as the only basis of trade with Austria and Poland until the establishment of clearings on August 10, 1934, and November 20, 1935, with these two countries respectively.

The characteristics of the German system of compensation in these instances and in its special "Aski" phase are permanence and the enforcement of a more or less overvalued rate on the Mark. The United States exchanged wheat against Brazilian coffee in 1931 and wheat against Chilean saltpeter in 1932, but these deals were made at free exchange rates and were recognized as emergency measures establishing no precedent.² The Austrian "private

1 Argentina, September 26, 1934, Chile, December 26, 1934, Colombia, July 1, 1937, Uruguay, November 6, 1935. The date of agreement with Brazil is not known precisely, but is supposed to be late in 1934. Cf. Schneider *op. cit.*, pp. 108-125, 140ff.

2 Oger H Bourdeaud'huv, *Accords de Compensation et Conventions de Paiement* (Antwerp 1938), p. 23.

clearing" transactions bore some resemblance to barter, but they gradually led to the establishment of a fairly "true" rate of exchange on the Schilling, so that their perpetuation was a matter of indifference.¹ In Germany, however, though the exchange-control authorities themselves permitted, and indeed fostered, a large number of devices tantamount to devaluations of the Mark, they strongly disapproved of any correction of the Mark rate under private auspices. The history of German compensations consists largely of attempts to render impossible the payment of concealed premia on foreign currencies, and yet to preserve as a permanent matter this safety-valve for the tightly compressed channels of trade under bilateralism.

Aski Marks are instruments of controlled barter payment for each stipulated commodity imported into Germany from a certain country is made by erecting an *ad hoc* seller's account, which he can then draw upon for German goods of certain categories under conditions laid down by the exchange control authorities.² At first, imports under the Aski arrangement were not subjected to the limitations imposed by the New Plan, and the huge accumulations in these accounts became a serious menace when even regions such as the Saar and Russia resorted to the accounts. Subsequently a devisen certificate issued by a Control Board was required for all imports under Aski, and the permission to import in each case also embraced the kind of goods which could be taken from Germany as the *quid pro quo*.³ But for the time being the authorities cherished the delusion that this cumbersome *ad hoc* procedure could be avoided by the formulation of certain general principles.⁴

(a) Exports under Aski compensation must be "additional," in order to avoid the transfer to this procedure of exports which would otherwise bring in free exchange.

1 Cf. pp. 47-52 above, and Milos Horna, "Clearing und Zahlungskompen-sation der Tschechoslowakei mit dem Auslande," in J. Mayer, M. Horna, A. Sourek, Neue Wege der Handelspolitik (Prag, 1936), p. 168.

2 The term "Aski" was coined from the initial letters of the full designation Auslander-Sonderkonten fur Inlandszahlung.

3 Muller, op. cit., pp. 282-284, of R.E. 46/38, Richtlinien IV, 14, Abs. 2.

4 By decree of December 9, 1934 (R.E. 157/34 Devisenstelle), Aski Marks were divided into two categories, firm Aski and bank Aski. The former, by requiring the preservation of identity of the foreign and domestic partners, came very close to pure barter, whereas the bank Aski, permitting purchase and sale of the instrument in the country of origin, tended in the direction of a free bill of exchange.

(b) Only economically important raw materials shall be imported,

(c) Prices of exports must be as high and the prices of imports as low as possible to achieve the most advantageous terms of trade.¹

By these stipulations it was believed that the Aski Marks could be developed into a "refined form of foreign trade."² The volume of Aski transactions mounted steadily from the autumn of 1934 to the end of 1935,³ and official optimism grew apace. The Berlin Business Cycle Research Institute, originally sceptical of the value of barter dealings,⁴ soon found complimentary remarks to make upon the system, and Wagemann, its director, foresaw a salutary effect upon Germany's trade balance.⁵

The profit motive of importers and exporters alike in no wise conformed to the general principles which were promulgated for compensation transactions. The relatively high domestic prices in Germany enabled the importer to offer high premia in such dealings, with the result that imports were stimulated and the overvaluation of the Mark was made painfully obvious. Furthermore, the rise of premia tended to advance the prices of goods not imported or manufactured from imported raw materials (for these would, in the absence of price regulation, be high in all events) but standing in a substitute relation to them.⁶ On the other hand as the premia developed, exporters were more and more tempted to divert their sales from channels bringing in free devisen, which had to be sold at the low Reichsbank rate, to the channel of compensation. The history of compensation, including the Aski variant, is a story of persisting private evasion and retaliation by authority. When the payments of premia were prohibited, the premia were paid and deposited abroad. When this also was prohibited, importers resorted to the secret payment of premia by taking over incidental costs and risks. And when the state extended its inspection to these minutiae in each transaction, there arose the so-called *à medida* deals between German exporters and importers, in which the former, for a share in the latter's profits on no- or low-premium

¹ Paul Bothe, "Die privaten Verrechnungsgeschäfte," Devisenarchiv, Vol. 2, No. 41, pp. 1177-1188.

² Arno Seeger, "Was bleibt vom 'Aski' Verfahren," Devisenarchiv, Vol. 3, No. 27, p. 317.

³ Bergmann, "Die Einschränkung des privaten Verrechnungsverkehrs," Devisenarchiv, Vol. 2, No. 11-12, p. 306.

⁴ V z K, Vol. 9, No. 3, Part A, p. 99.

⁵ V z K, Vol. 10, No. 1, Part A, p. 13, Wagemann, op. cit., p. 72.

⁶ Rudolf Eicke, "Warum Aussenhandel?" (Berlin, 1936), p. 42.

imports conveniently found it impossible to dispose of his wares in any other way than by Aski or other compensation accounts.

The difficulty of suppressing evasions led to a large number of regulatory decrees¹ and eventually to the decline of compensation. As early as March, 1935, a decree provided for careful investigation to determine whether the import were "additional," and listed certain goods as excluded from exports by compensation. If the import involved "unnecessary" goods, 30 per cent had to be paid in free exchange, and if foreign raw materials amounted to more than 20 per cent of the value of the export, the excess had also to be paid in free exchange. On December 27, 1935, new regulations were decreed which marked the beginning of the end of delusions nourished in Germany with regard to compensation and Aski trade. A new attempt was made to give an authentic interpretation of the term "additional exports"; this time they were represented as "exports which cannot be carried out against foreign exchange but only against purchases of foreign goods." That this definition, if applied to practical operations, actually left everything to the discretion of the authority investigating the individual case does not require proof. A new and much more extensive list of export goods which could not be admitted to compensations and Aski transactions was published. Another list concerned import goods which were considered indispensable; imports of goods not on this special list could be made by means of compensation only if the companion export were three times as large, two-thirds of the export price had thus to be paid in free devisen. The last regulation did not apply to South and Central American countries at this time but was extended to all countries in 1937. Throughout the whole period since the end of 1935 the use of Aski and compensation dealings was more and more eliminated in connection with clearing agreements. On November 5, 1936, a decree permitted only compensations of 50,000 Reichsmarks or more. In February, 1937, a new regulation stated that compensation transactions and trade by means of Aski Marks would no longer be permissible in trade with a number of oriental countries.² Compensation played an important

1. The most important of these decrees were R.E. 121/34 D St 10/34 Ue St, R.E. 177/34 D St 36/34, Ue St sub IV, R.E. 2/36 D St, R.E. 137/37 D St 46/37, Ue St sub II, 4. Cf. also Wolfgang Goedecke, "Das Prämienverbot bei privaten Verrechnungsgeschäften und sein Strafschutz," Devisenarchiv, Vol. 3, No. 44, p. 545 ff.

2. Burma, Ceylon, China, Egypt, India, Philippine Islands, Siam, Straits Settlements, and Sudan.

rôle in the liquidation of the French clearing, but disappeared in this segment of German trade thereafter. What was left worthy of mention in the sphere of barter transactions was the employment of bank Askı with Central and South America — here the technique more closely resembled clearing — and compensation for transactions in excess of 50,000 Reichsmarks with Arabia, British East Africa, British West Africa, and Iraq.

We have passed in brief review the revisions in Germany's international trade arrangements which were introduced in order to put into effect the strict bilateralism and the direct control of the composition of exports and imports contemplated by Schacht's New Plan. What were the results of this new dispensation?

B The New Plan in Operation

The development of Germany's foreign trade in the next few months after the enactment of the New Plan was not promising. The adverse balances of December, January, and February indicate

		Imports	Exports	Balance
(in million Reichsmarks)				
1934	July	362 7	321 2	- 41 5
	August	342 2	333 9	- 9 1
	September	351 8	350 3	- 1 5
	October	349 2	365 9	+16 7
	November	345 7	355 7	+10 0
	December	399 2	353 7	- 45 5
1935	January	417 3	299 5	-117 8
	February	359 7	302 4	- 57 3

that the underlying tendency toward import surpluses had not been conquered. Officially it was explained that these figures did not reveal the true state of affairs, first because, with the increase of compensation, exports frequently followed the companion imports by several months, and secondly because, with the appearance of new "raw material credits," another lag of similar character was interposed.¹ Estimates of the share of compensation in Ger-

1 The scheme of these credits involved importing raw material into Germany on credit, after the export of the manufactured goods to a third country, the purchaser there discharged the German debt by directing payment to the supplier of raw materials in the first country. As was generally the case with such attempts to preserve elements of triangular trade amidst the growing bilateralism, this method of conducting international trade, introduced in 1934, never attained an important magnitude.

man trade do not exceed 10 per cent¹ in these months when the trade deficit amounted to substantially more than this, and furthermore many barter dealings required a simultaneity of export and import, so that the official explanation fails to minimize the adverse trade development very considerably

This development indicated plainly that the original restrictions were inadequate. It has already been remarked that the New Plan had not made the possession of a devisen certificate a prerequisite of importation,² and still the authorities hesitated to impose so rigorous a measure. Custom officials were instructed to report goods which passed the frontier without devisen certificate, in order to provide a check upon illicit imports. Under a so-called "political prohibition on devisen clearance"³ of May 6, 1935, devisen certificates were made mandatory for imports from France and Czechoslovakia. This measure had as its immediate aim the exerting of pressure upon these countries in the midst of commercial treaty and clearing negotiations⁴, but it undoubtedly paved the way for the decree of June 24, 1935, prohibiting all imports without devisen certificates. On the other side, strenuous efforts were made to increase exports — by appeals to the goodwill of German firms, and by threats to close off the supply of raw materials for firms with slackening exports. Despite the increased severity of the exchange control regime, the German export quota (exports as a percentage of domestic production) remained at level far below its extent even in 1933, the year of most acute depression.

THE GERMAN EXPORT QUOTA 1931-1935*

1931	30 9%	1934	15 9%
1933	22 5%	1935	15 2%

* V z K, Vol 13 No 3 p 313

Voices were not altogether lacking in this very discouraging situation for a reconsideration of the wisdom of the "autonomous

1 Benning, op cit, p 47

2 Cf p 211 above

3 Devisenpolitisches Abfertigungsverbot

4 It is worth recording that these sharp weapons of the New Plan were used against the very two countries which in the autumn of 1934 had expressly demanded the enactment of Schacht's scheme, presumably as a defense against the accumulation of German clearing debts. Cf. *Economist*, August 3, 1935, p 230. This forms an amusing parallel with the case of the American bankers who in 1931 welcomed exchange control in Germany and urged a strict administration of the system.

economic policy" and autarky Gottfried Feder, the theorist of the National Socialist party, who had advocated a completely autarkic policy, was allowed to fall into oblivion Schacht spoke of the "run-down autarky nag,"¹ and Neurath, another member of the government, expressed the opinion that "the catch-word 'autarky' has been discarded," and that "no one in the government believes in the isolation of Germany from abroad."² Sentiment in favor of devaluation dared to come out into the open again, and a distinguished foreign economist ventured that, "It is to be anticipated that in the future Germany will not object to a policy that aims at gradually restoring to international trade, in some measure at least, the important part it formerly played in the world economy."³ But these hopes proved to be false In May, 1935, the levy on exports to provide a subsidy fund was imposed,⁴ and thereby another decisive step was taken in the course of economic isolation

Germany's foreign trade faithfully reflected the tenor of the New Plan To be sure, the last quarters of 1935 witnessed the supplanting of unfavorable by favorable balances, and the year closed with an export surplus of 111,000,000 Reichsmarks, but this outcome resulted from a percentual decrease of imports nearly three times as large as the percentual increase of exports Bilateralism left its impress in a decrease in Germany's favorable European balance and a decrease of her unfavorable overseas balance Imports from Europe in 1935 at 61.6 per cent of total trade reached the highest share since 1929, while the share of exports to European countries fell from 76.5 per cent to 73.2 per cent between 1934 and 1935, a development which carried on persistently up to the outbreak of the present war In 1935 the favorable balance of trade with Europe reached its minimum at 560,500,000 Reichsmarks, while the import surplus with the rest of the world was cut

1 Abgeklappter Autarkiegaul, cf Wagemann, op cit, p 4

2 Österreichischer Volkswirt, Vol 26, p 637 These remarks made in an address at Hamburg conflicted directly with Neurath's declaration at Bremen a short time before that it was imperative to "make our people and our economy independent of foreign foodstuffs and raw materials, and to produce at home everything which we can produce" Cf loc cit The contradiction indicates the contemporary confusion and the tenuous character of much which goes by the designation of "economic policy"

3 Bertil Ohlin, "International Trade and Monetary Policy," Index, Vol 8, No 115, p 154

4 Cf pp 239-240 below

down from 912,000,000 Reichsmarks in 1934 to 449,500,000 Reichsmarks in 1935.¹ The old trade system by which Germany paid with exports to Europe for her imports from overseas was obviously breaking down under the pressure of bilateralism. As we shall see in the next section, 1935 was the year in which the adverse effects of the new system made themselves most seriously felt. Figure 24

GERMAN IMPORTS AS A PERCENTAGE OF WORLD IMPORTS
AND GERMAN EXPORTS AS A PERCENTAGE OF WORLD EXPORTS

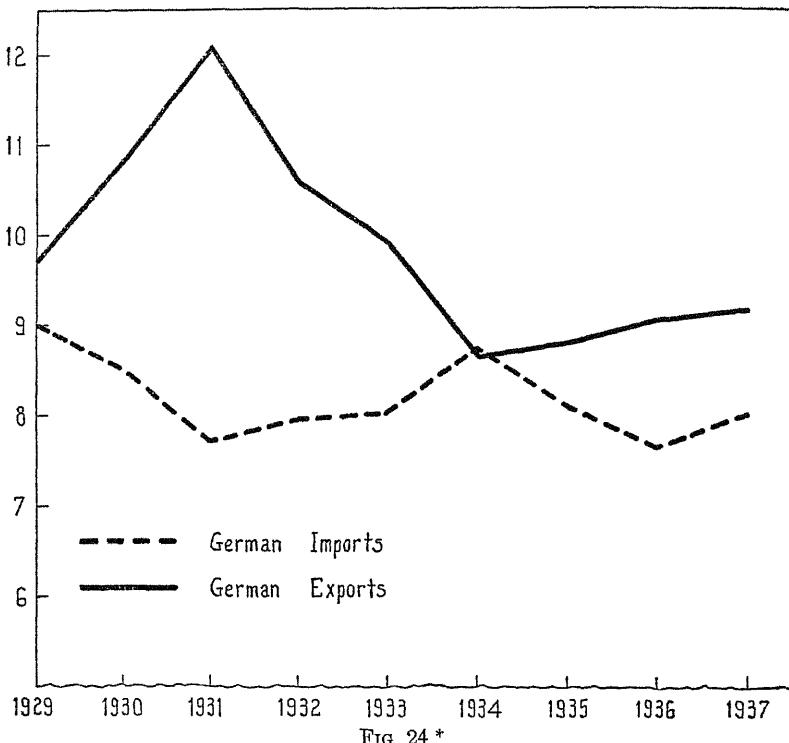


FIG 24 *

*For data and sources, see p. 393 below

shows the low level to which German exports relatively to exports over the world had fallen.

As far as concerns the composition of foreign trade, the trade statistics reveal a considerable success for the New Plan. On the export side the share of raw materials was pushed down from 11.1

¹ Cf. p. 385 below

per cent to 10·5 per cent, of foodstuffs from 3·6 per cent to 2·2 per cent, while exports of finished goods rose from 75·6 per cent to 77·6 per cent. On the import side the share of raw materials increased from 34·6 per cent to 37·7 per cent, while the percentage of finished goods imported to total imports fell from 12·9 per cent to 9·8 per cent. Foreign trade was undoubtedly being forced along the paths desired, at what costs this was achieved we shall see later.

Six months after the adoption of Schacht's New Plan — in March, 1935 — Hitler announced the withdrawal of Germany from the Disarmament Conference and the reintroduction of conscription, this signalized a new epoch not only in international affairs but in the German economy. Before, as after this turn, the extension of employment and output was financed by credit expansion, but as the Minister of Finance explained, work creation by public works was to a large degree supplanted by rearmament.¹ Henceforth it will be necessary to bear in mind constantly that the appraisal of exchange control and other economic policies, however much their truly economic efficiency may have counted even with the authorities of the National Socialist state, must bow to the frankly non-economic aims of the dominant political philosophy.

In the sphere of domestic finance, the volume of commercial and treasury bills had risen by 4,600,000,000 Reichsmarks between 1933 and 1935 and, if the tax-exemption certificates are included, by something exceeding 5,000,000,000 Reichsmarks. Total bill holdings of the banking system rose from 7,118,000,000 to 10,230,-000,000 and to 12,173,000,000 Reichsmarks from 1933 to 1935 and 1936, and the bill holdings of the Reichsbank from 3,149,000,000 to 4,423,000,000 Reichsmarks from 1933 to 1936.² As far as concerns the note circulation there was an increase of about one-third, or 1,000,000,000 Reichsmarks, from the middle of 1933 to the middle of 1936.³ The efforts of the German economic authorities to divert the increased flow of income away from consumption expenditure help to account for the "uninterrupted, though not alarming, rise in note circulation," as Poole points out, and another circumstance was the rise in relative significance of transactions by

1 Schwerin von Krosigk, *Nationalsozialistische Finanzpolitik*, Kiel
Vortrage No 41 (Jena, 1936), p 11

2 Reichskreditgesellschaft, *Germany's Economic Development during the First Half of the Year 1936* (Berlin, 1936), p 41

3 Cf pp 373-376 below

cheque¹ Furthermore as he observes, since the German people attached great significance to the note-circulation figure because of their sad experience in the post-war inflation, the authorities exerted themselves especially to restrain its increase Most of the new financing took the form of *Solawechsel* sold by the Golddiskontbank to commercial banks the proceeds being used to buy up Treasury bills (rediscounted at the Reichsbank) which lay at the base of work-creation activities Consolidation loans at frequent intervals transformed most of this short-term debt into funded obligations, though over the years 1935 to 1939 the *Solawechsel* circulation rose with marked fluctuations to one and a half billion Reichsmarks²

The first large operations by the government on the capital market began in 1935, being prepared for by the Loan Stock law of December 4, 1934, which limited dividends to six per cent and required the investment of excesses in the Golddiskontbank Sums paid into the Bank did not prove to be a substantial source of state finance, but the speculative advance of corporate securities on the exchanges was throttled and consumption curbed³ In January, 1935, the government carried through an eight billion Reichsmark mortgage bond conversion from 6 per cent to 4½ per cent by offering a single two per cent bonus to the owners and by announcing that those who did not notify of non-consent — the political strategy is apparent — within a brief period would be deemed to have consented⁴ Another two billion of Reich and provincial bonds were converted with equal success a month later Measures to lower bank interest rates were adopted in 1935 and 1936, and with the preparatory moves completed a series of funding operations during these years succeeded in mopping up 5,800,-000,000 Reichsmarks of short-term funds⁵

Fostered by a tremendous expansion of credit and by a consistent policy of turning back real income gains into investment, industrial production increased rapidly, especially in the favored category of capital goods But despite the exceeding of the pre-crisis level of industrial production in 1936, the volume of

1 Poole, op cit, pp 111, 161

2 Poole, op cit, pp 120-121

3 League of Nations, Monetary Review 1937-1938 (Geneva, 1938), p 56

4 Cf Guillebaud, op cit, pp 78-79

5 Reichskreditgesellschaft, Germany's Economic Development during the First Half of the Year 1937 (Berlin, 1937), p 51

GERMAN INDUSTRIAL PRODUCTION 1932-1936*

(1928 = 100, Monthly averages by years)

	All Goods	Capital Goods	Consumption Goods
1932	54 0	35 4	74 0
1933	61 5	44 9	80 1
1934	80 9	74 8	89 6
1935	95 3	102 4	85 6
1936	107 8	116 6	95 6

* Reichskreditgesellschaft Germany's Economic Development during the First Half of the Year 1937 (Berlin 1937) p 14

German imports and exports (computed at the prices of 1928) were 36 per cent and 21 per cent less than their level in 1928. The New Plan, whatever else its accomplishments, as for example, in changing the direction of trade,¹ was failing to keep the supply of imported goods, particularly of imported raw materials, abreast of Germany's needs in an epoch of strong economic expansion. Furthermore, and still more notably in view of the avowed principle of the Plan to adapt imports to available means of payment, German indebtedness on clearing accounts was becoming a chronic malady. It is by no means mysterious why this should be true. Between

GERMAN CLEARING DEBTS*

(In million Reichsmarks)

December, 1934	450	November, 1935	515
March, 1935	567	April, 1936	500
April, 1935	500		

* Economist Germany's Clearing Debts Vol 133 pp 485-486

1933 and 1936 world prices rose by 16 per cent, while German wholesale prices advanced by 13.7 per cent and prices in Germany of industrial finished and half-finished goods having their prices determined upon world markets increased by 23.5 per cent. Did the New Plan, as the official position maintained, actually prevent a bad situation from becoming worse or did it aggravate difficulties? This problem will be investigated in a subsequent section on prices and costs in bilateral trade. We may profitably conclude the present section on the technique of the New Plan by recurring briefly to the perennial and lively issue of the currency standard, and the connection between devaluation and the burden of foreign debts.

Throughout 1935 and 1936 devaluation was the center of spirited discussion in Germany. In August, 1935, Schacht threat-

1 Cf pp 223-224 above

ened to take vigorous measures against the "psychosis concerning real values",¹ and the situation came to be particularly tense in the spring of 1936, when an anti-Schacht faction within the Party demanded devaluation as the solution of foreign trade problems.² German export interests also shared this view, maintaining furthermore that concealed devaluation in the form of the export levy bore upon themselves alone, whereas outright devaluation would be "borne" also by importers.³ But the voice of the opponents prevailed, and export levies and subsidies continued. In defense of the government's position the arguments were merely a repetition of what had been said against devaluation after dollar devaluation in 1933.⁴ Such a move, it was said, would raise the prices of imported raw materials. In point of actual fact, as a subsequent section will reveal, this argument had only a narrowly restricted validity because of the rise of import costs under clearings and compensations. The psychological argument from the angle of the danger of a velocity inflation was still heard. Finally, it was held, devaluation would increase the burden of foreign debt. Now the truth of this contention is itself unimpeachable, but apparently in order to apologize for what may have seemed to be too frank a recognition of a genuine "my-gain your-loss" situation, the official German rejection of devaluation on the burden of debts basis was coupled with a specious argument which attempted to prove that "devaluations in the chief creditor countries seem to represent a cancellation of 4,000,000,000 Reichsmarks of foreign debts. But actually as a consequence of devaluations, the (German) export price level fell so low that the real burden of debt substantially exceeded the nominal burden."⁵ The logical relevance of this sort of consideration to the question whether Germany would herself gain by devaluation is not apparent, but even as an indirect apology for refusing to hand back to the creditor countries the windfall gains accruing to Germany from their devaluations, the argument cannot in fact prevail.

The basis for the official position, as the quoted sentence

1 In an address at the German East Fair at Königsberg, cf. Österreichischer Volkswirt, Vol. 27, p. 919.

2 Economist, Vol. 123, p. 237.

3 Waldemar Swoboda, "Vertagte Markabwertung," Österreichischer Volkswirt, Vol. 28, p. 704.

4 Cf. pp. 225-226 above, and Guillebaud, op. cit., pp. 23-24, 66-67.

5 VzK, Vol. 11, No. 1, Part A, p. 58.

reveals, is the adverse effects on German export prices produced by foreign devaluations. Concerning the adverse effect of foreign devaluations upon German export prices there can be no question. But in order to demonstrate that Germany's real debt burden was absolutely greater despite the nominal cutting of debt by devaluation, it is not sufficient to restrict the view exclusively to her *export* prices. A favorable balance of trade is not dependent simply upon export prices, but upon the relative development of export and *import* prices, that is to say, upon the terms of trade.

The collapse of raw material prices during depression turned the terms of trade strongly in Germany's favor, as shown in Figure 25. This movement reached its peak in 1932, subsequently, with the recovery of prices for primary products, Germany began to lose the advantage gained between 1929 and 1932, even at its low point in 1937 the ratio of export prices to import prices did not fall below 117.6 (1929 = 100), and in 1938 it had recovered again to 128.8. The effects of this development upon Germany's balance of trade are striking. By adjusting the actual values of German exports and imports so as to represent the volume of foreign trade at the prices of 1929, we obtain the result that Germany would have accumulated in the years 1931-1938 an *adverse* balance of trade amounting to 10,720,000,000 Reichsmarks. As it was, Germany was actually able to secure during this span an aggregate *favorable* balance of trade of 5,230,000,000 Reichsmarks. The excess of the balance of trade in actual values over the balance at the prices of 1929 amounted to 15,950,000,000 Reichsmarks.¹

Since the real burden of foreign debt depends upon the relation of import to export prices, we may obtain an approximation of the real burden by multiplying the nominal amount of debt at various dates by a factor in which the index of import prices is the numerator and the index of export prices the denominator. This gives the following results. It is naturally impossible to ascertain what course would have been taken by the terms of trade in the absence of sterling and dollar devaluations. But it is certain that in the actual situation, including devaluations, the real burden of German foreign debts, instead of increasing relatively to the nominal amount of debts in accordance with contention of German apologists for exchange control, actually decreased. The obstacle to devaluation from the angle of the burden of foreign debts was

1 Cf. statistics given on p. 392 below.

therefore a much less serious matter than represented, and furthermore, the magnitude even of the nominal debts had been halved since the introduction of exchange control

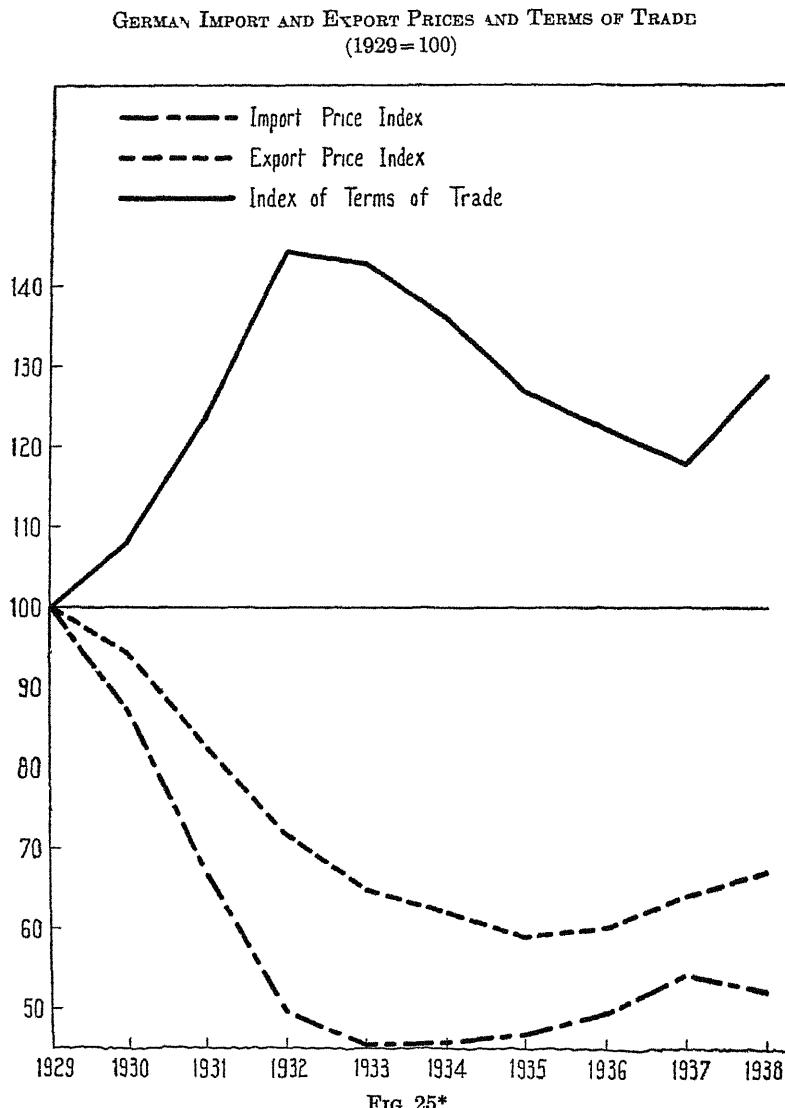


FIG 25*

* For data and sources, see p 392 below

Other arguments directed toward the correction of the German exchange disequilibrium by devaluation in 1935 and 1936 carry still less weight. It was held that the measure would usher in a period of rapidly rising prices. If, however, the devaluation of the Mark were not pressed below the parity of exchange equilibrium, no "mechanical" cause of price inflation would exist. Such "psychological" factors as a flight of capital to foreign currencies,

TOTAL VALUE OF GERMAN FOREIGN INDEBTEDNESS

(In billion Reichsmarks)

	Nominal*	Real†
July 31, 1931	23 8	19 27
November 30, 1931	21 3	17 25
February 29, 1932	20 6	14 21
September 30, 1932	19 5	13 45
February 28, 1933	19 0	13 30
September 30, 1933	14 8	10 36
February 28, 1934	13 9	10 29
February 28, 1935	13 1	10 35
February 29, 1936	12 4	10 17
February 28, 1937	10 8	9 72
February 28, 1938	10 0	7 78
February 28, 1939	9 5	

* League of Nations Balances of Payments 1937 (Geneva, 1938) p 110 ibid 1938 (Geneva 1939) p 58

† Computed from export and import price indices as given on p 392 below. Territorial changes in Germany deprive these indices of significance after 1938

including the pressure of Jewish emigrés' funds and a domestic flight through dishoarding, were already controlled with Diaconian severity through exchange control and domestic price regulation. With vastly less authoritarian control, the Czech Krone and the Belgian Franc were, at the same phase of developments, devalued without untoward consequences upon domestic prices. It was argued in Germany, further, that devaluation would provoke foreign retaliations, but the inverse proposition would seem more plausible, that it was the persistence and not the termination of Mark overvaluation which invited retaliation. Efforts on the part of Germany to offset the overvaluation were rather widely (and without much discrimination) regarded as dumping, as for example by the United States, which imposed special import levies on Ger-

man products in response to the German "export-subsidy" tax¹

All in all, by the close of 1936 the only real argument against devaluation was one which rarely came clearly into the light of publicity — its incompatibility with the "active economic policy" Despite the New Plan, foreign trade had taken such a turn that, in the words of the Reichsbank report of March 10, 1936, "only the most urgent needs of Germany could be satisfied" Once begun, economic planning seemed to show an inherent propensity toward indefinite expansion Devaluation would have stopped and eventually reversed the tendency, but a totalitarian state does not aspire to a reduction of its own importance The perpetuation and intensification of economic principles embodied in the New Plan, both in the domestic and foreign trade spheres, was possible, to quote a German commentator, because Germany was "willing to bear the heavy economic armor, the pressure of which was felt always and everywhere, and which narrowly hampered free action"²²

Compare this evaluation with the pronouncements of a recent and fervent defender of the German control system Referring to the New Plan, Dr Fritz Meyer states in his memorandum to the Bergen Conference that

"the raw material quotas and the preferential allocation of labor for export industries led to just such a liberation of goods and services from domestic consumption as there would have been under the price mechanism of a free-exchange economy And because the sale of exports involves a pricing problem not solved by the mere liberation from domestic consumption, the additional export procedure pushes the level of export prices down as far below the general domestic price level as competition requires"³

Upon this basis Meyer is ready to reach the conclusion that

"the German exchange control is a new monetary system, which, of all systems existing at the present, embodies in the purest way the fundamental principle of the classical gold standard, that is to say, the maintenance of a stable exchange rate by adjustment of the domestic price level"

1 League of Nations, World Economic Survey 1935-1936 (Geneva, 1936), p 200 Countervailing import duties from 22½ per cent to 56 per cent *ad valorem* were placed on many German products imported into the United States

2 H Schumacher, op cit, p 225 The tense of the verbs has been changed

3 Fritz Meyer, "Devisenbewirtschaftung als neue Wahrungsform," Weltwirtschaftliches Archiv, Vol 49, No 3, pp 465-466

Were the "stable exchange rate" represented by the official value of the Reichsmark actually achieved by an "adjustment" of prices within Germany, it would be pointless to proceed, as we do in the next section of our analysis, to a discussion of the overvaluation of the Mark. Equilibrium would have been brought about by deflation. Alternatively, a reduction of the official value of the Reichsmark would have removed the difficulty which Meyer refers to tactfully as "a pricing problem not solved by the mere liberation (of resources) from domestic consumption." When the German authorities rejected these alternatives, they also rejected the "fundamental principle of the classical gold standard," which is its automatic or quasi-automatic operation. According to Herr Funk, the Minister of Economics, the export trade involved some 40,000 separate transactions daily, with upwards of 40 forms to be filled out for each transaction.¹ This may be suitable to the purposes of the totalitarian state, but it can scarcely be thought compatible with the principles of an international gold standard.

THE OVERVALUATION OF THE MARK

To define the equilibrium rate of exchange formally is one thing, to determine its value empirically is another. When the question involves the degree of overvaluation of a currency during profound economic and financial disturbances, especially when the ordinary economic variables such as commodity prices, wages, interest rates, exports, imports, and capital movements are subject at every turn to authoritarian interference such as "price stops," subventions, quotas, tariffs, and exchange control, the problem becomes formidably intricate. The equilibrium rate itself has been definitively described by Pigou as the rate which satisfies the condition for commodities entering into international trade that "a unit in the country of export shall buy a claim in the country of import to a unit minus the cost involved in sending it there"², or in other words, that aside from discriminating monopoly, profitable international arbitraging operations in commodities are impossible. But this definition, however logically invulnerable, involves something "easier said than done," for it does not afford more than an indication of the economic facts relevant to equilibrium, nor more than a vague suggestion as to what statistical

1 Guillebaud, *op. cit.*, p. 222.

2 A. C. Pigou, *Essays in Applied Economics* (London, 1923), p. 157.

operations would be required for computing the rate. The Casselian purchasing power parity does indeed provide a definite line of attack, and, in the relative form used exclusively since its modification by Cassel himself, this computed parity indicates the equilibrium rate, provided a base year of relative equilibrium can be discovered, provided capital movements, relative intensities of international demand, and the differential values of tariffs and costs of transportation between the countries involved have not changed much since the base year, and provided finally there have been no devaluations.¹

One objection to purchasing power parity — that, following a foreign devaluation, prices either at home or abroad must adjust to the new parity rather than *vice versa* — loses its force when, as at present, the discussion does not assume as a datum the gold or gold-exchange parity of the home currency, but instead enquires how large a devaluation in the home currency would be necessary to establish equilibrium. Another complication is present but not crucially important — can any year be found sufficiently representative of international equilibrium to serve as a base? The stabilization of the pound in 1925 is commonly supposed to have settled upon too high a level, and the valuation of the franc after 1928 to have followed too low a level.² Furthermore it was undoubtedly true that an international price system was imperfectly realized in these years, if it is rigorously defined as requiring that "not only wholesale prices, but costs of living, wages, and interest rates are in perfect harmony."³ But as Pigou insisted, though incomplete economic equilibrium can easily jeopardize exchange equilibrium, the latter can be perfectly realized without a thoroughgoing economic equilibrium, and for practical purposes, moreover, approximate allowances can be made for the pre-crisis under- and overvaluations. The most serious obstacle to the employment of purchasing power parity for European currencies since 1931 is the distortion of the prices of internationally traded items from general

¹ As to why and how these changes distort purchasing power parity away from true equilibrium, cf. Howard S. Ellis, *German Monetary Theory, 1905-1933* (Cambridge, 1934), Ch. XVI, and *idem*, "The Equilibrium Rate of Exchange," Ch. III in *Explorations in Economics* (New York, 1936), pp. 26-31.

² League of Nations, *World Economic Survey 1934-1935* (Geneva, 1935), p. 50.

³ J. B. Condliffe, "Exchange Rates and Prices," *Index*, Vol. 10, No. 109, p. 5.

domestic prices such as are embodied in wholesale or cost of living indices. Of the forces underlying this distortion, capital exports were most potent as long as they persisted, but we are probably warranted in ignoring them after the imposition of exchange control, and certainly warranted after the resort to complete moratorium.

Thus far the limitations upon purchasing power parity as a measure of overvaluation are not in the aggregate serious. Let us examine the results of this sort of calculation in the German case.

GERMAN WHOLESALE PRICES EXPRESSED AS PERCENTAGES
OF BRITISH WHOLESALE PRICES BY QUARTERS*
(1925-1927 = 100)

	I	II	III	IV
1931	111 33	112 02	117 22	143 28
1932	141 62	138 43	145 74	150 33
1933	145 59	147 31	151 39	156 72
1934	160 53	165 36	171 27	177 22
1935	178 41	173 03	171 56	166 96
1936	168 12	168 75	162 40	159 04
1937	147 76	143 87	148 39	155 69
1938	160 66	166 48	175 63	186 17

* To make allowance for an approximate 10 per cent overvaluation of sterling (1925-1931) British wholesale prices were first adjusted upward by 11 1 per cent. For the underlying series of p. 138 below.

In a literal sense we have here simply a numerical expression of the relative degrees of general monetary deflation and inflation as between England and Germany. For the very long run, and in the absence of special one-sided obstacles or stimuli to trade, these figures would show the approximate overvaluation of the Mark. But we are dealing with the short run and with a situation pre-eminently characterized by one-sided forces which distorted the effective prices of internationally traded goods and services away from general domestic price levels. To ignore this crucial difference, as Cassel apparently did in estimating the Mark to be 57 per cent overvalued in 1934,¹ is to overlook the entire gamut of devices by

¹ Gustav Cassel, "Ein Gleichgewichtsproblem," Skandinaviska Kredit-aktiebolaget, January, 1935, p. 2. Cassel correctly took as the basis English prices converted to a *gold* basis for purposes of comparison with a Germany still using an official gold Mark. In this way he at least avoided the error of the Economist, which employed English "paper" prices and thus arrived at a

which Germany sold her wares at prices below her own wholesale prices converted to foreign money at the official Mark parity, that is, the widespread use of various categories of cheap "blocked Marks" and the resort to export subsidies. These procedures cause the estimates of overvaluation in a simple purchasing power parity calculation to exceed the overvaluation of the Mark in effective prices to foreigners. We cannot therefore employ this parity itself, but in conjunction with other facts we shall find it very useful at a later juncture.

The extensive use of blocked Marks for German exports has not unnaturally suggested to certain writers¹ that the discount upon these subterranean varieties of the Mark might be employed as a measure of its overvaluation. Against this stands the attitude of authorities in Germany that discounts upon blocked Marks have nothing whatsoever to do with a devaluation of the German standard nor, by implication, with an artificially high official Mark rate. Even the term "blocked Marks" was for a time shunned by the German literature in favor of "blocked accounts", and this terminological nicety was taken as proof that the blocked accounts, negotiable at a discount, had no connection with the Reichsmark.² This attitude, it need scarcely be said, is completely specious. Yet I should agree with Professor Harris when he maintains that

"the degree of depreciation obtained by calculating a weighted average of the price of marks on exchange markets does not give us the proper correction. The German subsidy method . . . for a *given* depreciation of the mark is much more effective than a corresponding depreciation of sterling (say). The German bounty is obtainable only when it counts, a condition which does not prevail under usual conditions of depreciation. For this reason, a depreciation of the mark of 25 per cent, *ceteris paribus*, may well be as effective in ridding the country of overvaluation as a depreciation of 35–40 per cent elsewhere."³

Balogh's phrase "selective depreciation" aptly characterizes the serious underestimate of Mark overvaluation in June, 1934, at 15 per cent against sterling and 27 per cent against the dollar, cf. *Economist*, Vol. 118, p. 1258, and pp. 1378–1379.

1 E.g. Mark Mitnitzky, "Germany's Trade Monopoly in Eastern Europe," *Social Research*, Vol. 6, No. 1 (February, 1939), p. 35.

2 E.g. Rudolf Eicke, "Sperrguthaben und ihre Verwendungsmöglichkeiten," *Der deutsche Volkswirt*, Vol. 10, No. 18, p. 803; H. Schumacher, *op. cit.*, p. 223.

3 S. E. Harris, "Measures of Currency Overvaluation and Stabilization," Ch. IV in *Explorations in Economics* (New York, 1936), p. 43, Harris's italics.

German system of multiple exchange rates,¹ and it accurately paraphrases Harris's description of the export bounty as "obtainable only when it counts." But the term "overvaluation" is understood by most persons, I believe, to refer to the margin by which a *single and unique* rate of exchange would have to be lowered to produce equilibrium, that is to say, under Harris's "usual conditions of depreciation." Unless we were to use the term in a quite strange and easily misunderstood sense, the "overvaluation" of the Mark cannot be found, at least directly, in the multiple values of blocked accounts.

Bearing in mind the lack of parallel between ordinary devaluation and the discriminatory variety, we shall make use later of the aggregate amounts applied to the furthering of German exports through depreciated Marks. Reflection upon this aggregate immediately reveals that it cannot be used in isolation. German exports were also furthered by direct subsidies obtained by levies upon home industries or simply by an additional item in the Reich budget. But when the *Economist* concluded in the autumn of 1935 that a 25 per cent devaluation would be necessary to produce equilibrium, using only these direct subsidies as a basis for calculation, it likewise erred in the direction of understatement.² The significant aggregate embraces both the total of discounts on blocked Marks and the total direct subsidies of all sorts, and even with this aggregate at hand we have only one of the components of a complete picture of the overvaluation of the Reichsmark. There is therefore small wonder that quotations upon blocked Marks, taken in isolation, lack significance. These series are reproduced in the statistical appendix³, but they bear little resemblance to other and more reliable indices of overvaluation, either in magnitude or in temporal variation.

With respect to one particular category of blocked Marks, the Aski, there might appear to be good reason for supposing that the prevailing discount would afford a satisfactory index of Reichsmark overvaluation. The Aski were acquired through current exports to Germany with full knowledge of their field of utilization, and not through frozen debts acquired long before exchange control had been contemplated. Their prices were formed by free negotiations

1 Balogh, *op cit.*, p. 481.

2 *Economist*, Vol. 121, No. 4802 (September 7, 1935), p. 472.

3 Cf. pp. 397-398 below.

between buyers and sellers, and, initially at least, their possible uses were quite numerous. From this combination of facts one might expect to derive prices which would show directly the relation of German to foreign prices on the significant items of international trade. But almost from the beginning the Aski accounts were subjected to curtailment as to uses, the list of Aski countries was reduced, and the accounts of nationals of the remaining countries were made the subject of differential treatment. In 1935 Aski Marks were selling at a 20 per cent discount in the United States, 30 per cent in Chile, and 35 per cent in Colombia.¹ They came to be another instance of "selective depreciation", and their multiple values, just as with the other categories of blocked Marks, could not be taken to measure the depreciation which would be necessary for Reichsmark currency as a whole. Since 1937 their employment has decreased so far as to render the question somewhat academic.²

Let us turn from the blocked accounts to explore the possibilities of a comparison of export prices. This method of estimating the equilibrium rate of exchange has been championed by Harris, though without special reference to Germany or other exchange-control countries.³ The advantage of this method is that it eliminates the prices of "purely domestic" commodities and costs of production, and retains only those actually entering into foreign trade. Harris rejects the objection — as I have also⁴ — that export prices tend to be uniform the world over, if allowance is made for transportation costs and exchange rate, upon the basis of convincing empiric evidence to the contrary. What results are obtained from the export price comparison for Germany, taking export prices in England as the "other country," not only because of its own importance in German trade but also because of its representing the entire sterling *bloc*? Such a computation would seem to lead to the conclusion that if, as the index shows, the pound and Mark were in equilibrium at the prices and exchange rates of 1931, a 21 per cent overvaluation of the Mark had developed by the next year, and that the overvaluation had occasionally decreased below this figure but did not rise appreciably above it through

1. Neue Zürcher Zeitung, October 29, 1935.

2. Economist, Vol. 136, No. 5007 (August 12, 1939), p. 321.

3. Harris, *op. cit.*, pp. 41-42.

4. Explorations in Economics, pp. 28-29, and n. 3.

GERMAN AND BRITISH EXPORT PRICES*
(1927 = 100)

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
1 British Gold†	111.1	104.3	84.1	60.4	56.8	52.7	50.3	52.4	57.0	56.1
Export Prices										
2 German Export Prices‡	100.0	94.1	82.5	71.6	64.7	62.0	59.0	60.0	64.0	67.1
3 2 as percent age of 1	90.0	90.2	98.1	118.5	113.9	117.6	117.2	114.5	112.3	119.6

* League of Nations Review of World Trade 1938 (Geneva 1938) pp. 74-79.

† British export prices have been adjusted upward by 11 per cent to allow for a 10 per cent overvaluation of sterling in 1927-1929.

‡ German prices for 1938 refer to the old Reich excluding Austria but including Sudetenland for the last quarter of the year.

1938 But this result diverges radically not only from general observation but also from other computed Mark parities on which it is possible to place greater reliance. The obvious shortcoming of the export price comparison for Germany is its failure to allow for the sale of special kinds of Marks below official parity and for the sale of goods at less than cost of production through export subsidies. But can we not utilize the export price parities by making allowance for these authoritarian methods of supporting exports?

The German government took great care to spread a veil of secrecy over its export subsidy system. No information has been divulged through regular channels, and German firms were even forbidden to enter the sums received in their books. We have therefore to rely upon scattered estimates occasionally published abroad. The export subsidy raised by the levy upon German industry and commerce after June, 1935,¹ amounted to a 2-3 per cent turnover tax, in 1935 it was expected to yield 700,000,000 Reichsmarks from industry and 300,000,000 Marks from commerce and the banks, and in 1936, 600,000,000 Marks from industry, 300,000,000 Marks from agriculture. Actual proceeds fell short by 100,000,000 Marks in 1935, but came up to expectations in 1936. For 1937 and 1938 the levy for exports ranged between 800,000,000 and 1,000,000,000 Marks.² It is even more difficult to ascertain the extent of support given to exports by means of blocked Marks and

1 A law empowering the Reich Chamber of Economy to impose such a levy was promulgated on June 29, 1935, but the levy is known to have been in force *de facto* for several months previous to this date.

2 Economist, Vol. 121, No. 4802 (September 7, 1935), p. 472, Neue Zürcher Zeitung, April 30, 1936.

the repurchase of German bonds, but it has been estimated for the four years 1935 through 1938 at 600, 700, 700 and 500–600 million Marks¹ Applying these figures to exports, we obtain the following picture of government subsidies

GERMAN EXPORT SUBSIDIES, 1935–1938
(in million Reichsmarks)

	Proceeds of the Tax	Blocked Marks and Bonds Repurchased	Total Funds for Subsidy	Exports	Percentage of Subsidy
1935	900	600	1500	4270	37.5
1936	1000	700	1700	4768	35.6
1937	800–1000	700	1500–1700	5911	25–30
1938	800–1000	500–600	1300–1600	5263	25–30

It would be rash to conclude from these figures, however, that the percentage of subsidy had fallen markedly in 1937 and 1938. By this time most of the German trade with Southeastern Europe, including Czechoslovakia, had been brought under domination of the German clearing system and the sphere of influence of the Mark, and we are safe in assuming that no subsidies were required. Eliminating the one-sixth of German exports which went to this region and distributing the subsidy over the remainder, we arrive at percentages of subsidy for 1937 and 1938 in the neighborhood of 35 per cent. There is a temptation to regard these percentages, running at about the level of 35 per cent for the years 1935–1938, as directly expressing the overvaluation of the Mark, but a truer account is given by these figures in conjunction with certain others.

Let the reader compare for himself three intimately connected phenomena, the interrelation of which we have indeed adumbrated but never before made explicit — German wholesale prices in comparison with wholesale prices abroad, German and foreign export prices, and the German export subsidies.² Each of these ratios has been proposed in some quarter or other as the measure of Reichsmark overvaluation, but it is only the composite of all three which reveals the actual situation. For reasons presently to be dwelt upon, no attempt is made to assemble these series in tabular

1 Financial News, November and December, 1937 Economist, Vol 133, No 4973 (December 14, 1938), p 694

2 Cf pp 235, 239 above

form in order to offer precise numerical statement of the overvaluation. Yet it will be apparent that the series articulate with one another. Over the period 1935–1938 for which estimates of export subsidy exist, the percentage of *subsidy* at 35 per cent to 37 per cent very nearly, though not completely, fills the gap between the excess of German over British *wholesale* prices (moving most of the time between 48 per cent and 78 per cent) and the excess of German over British *export* prices (12 per cent to 20 per cent). None of these circumstances is surprising, and they house with one another harmoniously. A complete bridging of the gap between the relation of wholesale prices at home and abroad and the relation of German and foreign export prices is not to be anticipated, because of the economical application of devaluation through differential rates on various goods to various countries.¹ Export prices were, in other words, reduced below the high level of wholesale prices in Germany by a greater amount than a simple average of subsidy per unit. On the other hand, even this adroitly applied subvention did not suffice to offset the relatively high domestic prices, with the result that export prices remained from 12 per cent to 20 per cent higher than the British. This result made itself felt in a decline of German exports from 12 per cent of world exports in 1931 to eight per cent to nine per cent over the period 1935–1939, a decline in relative share of one-third to one-fourth.² With regard to the prices foreigners were actually paying for German goods, the Mark was on the average overvalued by 12 per cent to 20 per cent, with regard to the relation of internal prices at home and abroad which would have been significant for a unique and general devaluation, the Mark was overvalued from 50 per cent to 75 per cent, i.e. requiring a devaluation by 33½ per cent to 43 per cent.

There are three notable circumstances which would point to an overvaluation in fact exceeding even the upper limit of the estimates. In the first place, it is improbable that the export subsidies were sufficient to prevent actual loss to many firms on certain exports, the magnitude of subsidies being calculated only to preserve a modest competitive profit on a year's operations. Normal considerations of profitability had frequently to give way before the onslaught of propaganda in favor of the so-called "foreign exchange principle" (*Devisenprinzip*) as against the ordi-

1 Cf pp 236–240 above

2 Cf p 393 below

nary "foreign trade principle" (*Kostenprinzip*)¹ Furthermore, the formation of an exchange-control *bloc* under German domination made it possible for Germany to push her exports by a variety of devices other than the reduction of export prices. Both of these circumstances pertain to the comparison of export prices, and make the German prices lower than they would be under the ordinary competitive conditions which underlie the traditional concept of equilibrium rates of exchange. The third qualification, on the other hand, pertains to the comparison of wholesale prices figuring in the purchasing power parity concept. For years the German authorities have been intent on suppressing any tendency of prices to rise. It is not inconceivable that one part of the "suppression" should have been the resort to statistical maneuvers such as the not altogether disingenuous shifting of base years, weighting system, or sampling, which might retard the advance of price indices.² Another part of the suppression was, of course, the decreeing of maximum prices and the introduction of rationing practices which constrained the depreciation of the Mark within narrower limits than otherwise.

For 1939 a sudden and considerable rise in overvaluation seems probable. The attainment of full employment, the scarcity of certain kinds of labor and raw materials, and the increased pressure on production from the side of armament surely point in this direction, and the reported doubling of the export subsidy tax is consonant with this development.³

LOSS AND GAIN IN BILATERAL TRADE

A *German Import Prices*

(1) General Observations An overvalued currency unit usually signifies that the country secures in international trade

1 Fritz Huhle, *op cit*, p 191, John Brech, "Der moderne Merkantilismus," *Wirtschaftsdienst*, 1934, No 26, p 875

2 When Mr Guillebaud pleads that "one moment's reflection will show" that publication of two sets of figures for official and public use is not practicable, he should be reminded of a similar question, much discussed in the 'twenties, with respect to Russian statistics. At that time one of the foremost authorities in Russian economics, the late Professor Zagorski, very convincingly showed that double sets of figures were actually in use, at least as far as concerned certain parts of the published Russian materials. Cf Guillebaud, *op cit*, p vi, and S Zagorski (Russian text), *The Economic Situation in Russia* (Paris, 1926), p 134. I am obligated to Dr Gerschenkron for the exploration of this work in Russian.

3 *Economist*, Vol 133, No 4975, p 694

more favorable barter terms than otherwise its exports fetch more and its imports cost less than they would at an equilibrium rate of exchange. The overvaluation of the Mark with respect to non-exchange-control countries, however, produced a less favorable turn to Germany's barter terms than might be expected if account were not taken of the large amount of exporting at rates below the official Reichsmark parity. Furthermore, in clearing and compensation trade, the German authorities occasionally took some account of the artificiality of the Reichsmark rate, though the concessions seldom were enough to realize anything approaching a true rate. In the last four or five years preceding the present war, upwards of 80 per cent of German trade went through clearings and compensations. Rates of exchange in these relations were subject to constant maneuvers, varying strikingly between partner countries. Trade with countries having free currencies also passes through special rates depending upon the particular country and the particular variety of blocked Mark involved. In the section just concluded we have seen that the overvaluation was incompletely offset by these special rates and by direct subsidies, and that an uncovered margin of 15 to 22 per cent in comparison with England still remained on the average. How much of an advantage accrued to the German economy by selling goods at this artificially high price margin, and to what extent the gain was offset by subsidy costs and other forms of non-economic exporting would be interesting facts for the student of exchange control. But the intricacy of the situation, the suppression of relevant information, and the impossibility of knowing how matters might have stood regarding the terms of trade in the absence of the course actually taken combine to make this particular phase of exchange a closed book.

Some indication of actual developments in the matter of the "gain" of foreign trade may nevertheless be derived from comparisons between the costs of imports from exchange-control and from free-payments countries. It does not answer the question concerning aggregate gain, which is probably a theoretical and statistical surd, even in the absence of complications set afoot by exchange control with an overvalued monetary standard, but it does something toward showing which way the wind blew. Let us proceed to this inquiry.

The forcing of trade into bilateral channels after 1931, particularly after 1933, produced a momentous dislocation of German

GERMAN TRADE WITH EUROPE AND THE REST OF THE WORLD
AS PER CENT OF TOTAL*

	Imports		Exports	
	Europe	Rest	Europe	Rest
1931	55.9	44.1	81.0	19.0
1932	53.6	46.4	81.0	19.0
1933	54.3	45.7	78.0	22.0
1934	57.5	42.5	76.5	23.5
1935	61.6	38.4	73.2	26.8
1936	59.8	40.2	70.7	29.3
1937	55.6	44.4	69.3	30.7

* For source and fuller data cf p 385 below

exports away from European toward more distant markets. Not only did this entail mounting costs of placing German products at the doorstep of the final buyer, but also the loss of triangular trade through which Germany had traditionally paid for her purchases of overseas raw materials by her European export surplus.¹ The evolution of German imports over the same period is not dominated by the same trend. Until 1936 Germany was apparently unable to maintain the former proportion of overseas purchases through the increasing pressure of European clearings, but the elaboration of clearing and compensation arrangements thereafter, especially with South American countries,² made good the loss, at least in the proportion of imports. Within the broad class of European imports, however, there was a consistent and persistent drift away from the western European creditor nations — Great Britain, France, Belgium, the Netherlands, and Switzerland — as follows:

1931	23.2	1935	20.3
1932	20.6	1936	18.4
1933	20.9	1937	17.7
1934	20.7	1938	16.9

The successive reductions of German debt service preclude the explanation that imports fell in response to the development of a

1 The developments shown in the foregoing percentages of European and non European trade are still more marked if allowance is made for the fact that the statistics included Turkey under Asia to 1936 but thereafter under Europe. If the former classification is retained, we obtain the following

	Imports		Exports	
	Europe	Rest	Europe	Rest
1936	57.0	43.0	69.0	31.0
1937	53.8	46.2	67.4	32.6

2 Cf pp 217-218 above, and pp 386-387 below

capital surplus in the balance of payments, the explanation lies in the difficulties of making purchases with strong currency countries, and in Germany's increased economic and political interest in Southeastern Europe

The violent shifting of exports during the course of exchange-control history from European to overseas countries and of imports from Western to Southeastern Europe brought its economic cost, bilateralism inevitably narrows the range of markets for both selling and buying, as emphasized in the introductory chapter¹. During the period when bilateral trade under clearings was officially regarded as the nefarious work of foreign creditor nations, it was permitted to speak of the unfavorable results of this sort of trade, candid expressions of disapproval were widespread². In 1935 the Institute for Business Cycle Research (Berlin) could venture to reveal the illuminating figures on page 89 regarding import costs from clearing and non-clearing countries

Most dramatic are the excesses of clearing over non-clearing prices in the cases of oil, cotton, and wool, which show margins in the third quarter of 1935 of 45 per cent, 24 per cent, and 24 per cent. A decline in the price of petroleum on free-currency markets in 1935 was actually accompanied by a rise in the clearing price. Not all prices throughout the three-year period reveal the same tendency, but in general there is a striking preponderance of prices in clearings exceeding the free-currency levels. Oil fruits and seeds depart from this pattern only in the last quarter included. For lumber there is a reversal of the general tendency in 1934 and in the third quarter of 1935, but the absence of an official clearing with Austria, an important source of German supply, and the inclusion of Austrian imports through the device of compensation under "non-clearing" countries account for this change. In the case of cotton in 1933 and 1934, the crop and marketing restrictions of the United States are responsible for the deviation. Copper in 1933 represents the only extreme reversal of a general tendency for the German import prices through clearings to exceed the prices through

1 Cf p 25 above

2 Cf Huhle, *op cit*, p 206, and idem, "Das Clearingwesen im Aussenhandel vom deutschen Standpunkt aus," *Jahrbucher fur Nationalokonomie und Statistik*, Vol 146, No 2, pp 171-205, *Reichskreditgesellschaft*, Germany's Economic Development in the First Half of 1938 (Berlin, 1938), p 48, and idem, *Germany's Economic Situation at the Turn of 1937-1938* (Berlin, 1938), p 50, Benning, *op cit*, p 58

AVERAGE IMPORT PRICES OF IMPORTANT RAW MATERIALS
PURCHASED BY GERMANY FROM CLEARING
AND FROM NON-CLEARING COUNTRIES*

(In Reichsmarks per metric ton)

a, All Countries, b, Clearing Countries, c, Non-Clearing Countries

Commodities		1933	1934	First half 1935	Third quarter 1935
Wool	a	1,345	1,791	1,524	1,747
	b	1,540	1,833	1,692	1,902
	c	1,218	1,756	1,269	1,526
Cotton	a	649	651	797	848
	b	490	592	898	964
	c	658	663	708	780
Lumber	a	55	53	51	53
	b	55	51	51	51
	c	54	55	51	59
Oil fruit and oil seed	a	117	99	110	121
	b	133	114	123	121
	c	109	89	102	121
Petroleum and its derivatives	a	48	44	44	42
	b	65	57	53	55
	c	47	43	41	38
Copper	a	494	423	357	382
	b	526	426	357	383
	c	444	421	357	380

* V z K Vol 10 No 3 Part A (1935 N S) p 323

free exchange. In view of the importance of this matter it seems advisable to select the most eligible commodities for further statistical investigation, and to subject them to more detailed analysis.¹ The case of cotton affords a particularly intimate view of the operation of bilateral trade, copper and wool present less simple cases, but general tendencies are nonetheless discernible.

(2) The Costs of German Imports of Cotton. The analysis of German imports of this commodity includes the physical volume and the total value paid for imports of cotton by countries of

1. The choice of commodities for investigation is narrowly limited by the available statistics. The extension of clearings in many cases completely eliminated imports from free currency countries, and thus eliminated the possibility of price comparisons. In other cases different commodities are embraced under one customs heading. Finally the reorganization of the German trade statistics in 1937 prevented the continuance of price comparisons beyond that year.

origin, the relative shares of each of these countries in the total importation, the average import price paid by Germany as a percentage of the world price, and finally, the ratio of prices obtained from Germany by specific clearing countries to prices obtained by a non-clearing country. The figures of physical volume show a strong shrinkage of cotton import, even in 1936 and 1937, in the midst of a high degree of employment in Germany, this import fell short even of the crisis year of 1931.¹ On the whole, however, exchange control and clearing did not lead to as great a collapse as might be expected: cotton imports persisted at about three-fourths the pre-crisis level. It is not in the total volume but in the allocation of imports and the costs that we see the disruptive force of bilateralism.

Before 1931 something like two-thirds to three-fourths of German cotton imports were obtained from the United States, about one-tenth from British India, and about one-fifth from Egypt. Only minor variations in the share of these three suppliers occurred before 1934: the Indian share declined somewhat, but the United States maintained its predominating position. The introduction of Schacht's New Plan in 1934, with its intensified drive for bilateralism of trade, changed this scene completely, as may be seen by a comparison of 1934 and 1935 with the preceding years in Table I. The share of the United States in German imports of cotton fell abruptly to little more than one-fourth, Egypt doubled its relative pre-crisis share, Brazil rose in an astonishing fashion from almost nothing to one-fifth, and Turkey appeared upon the list of countries, with a modest share it is true, but evidently because cotton culture was introduced with the sole purpose of supplying Germany. British India maintained its approximate position, but this was possible only through a cost to Germany which we presently explore.

Later developments did not substantially alter the new situation of 1934-1935. Imports from Brazil fell temporarily in 1936 to half their 1935 level and recovered the ground lost by 1937. This sudden decline was caused by the termination of the German-Brazilian clearing agreement at the instance of Brazil, allegedly (in Germany) because of pressure by the United States,² but in

¹ Cf p. 150 below.

² Reichskreditgesellschaft, Germany's Economic Development in 1935, p. 55.

	A DECADE OF GERMAN IMPORTS OF COTTON									
	I SHARES OF INDIVIDUAL EXPORTING COUNTRIES AS PERCENTAGE OF TOTAL GERMAN IMPORTS*									
	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
Egypt	4.13	5.07	5.72	7.83	8.0	8.41	11.25	9.96	9.11	11.68
British India	10.41	12.01	12.91	9.89	5.5	8.10	9.41	8.09	11.94	10.45
U S A	72.93	70.50	68.37	67.55	75.0	72.09	55.12	26.72	35.95	33.89
Turkey			56	38	5	01	1.45	3.88	5.00	2.41
Brazil	16	15	89	66	05		2.07	20.83	11.73	20.04
Argentina	48	72	79	61	11	1.11	1.42	3.65	2.96	1.68
Peru	57	45	1.38	2.70	2.0	2.05	2.84	6.36	5.78	5.31
Mexico	19	49	02			08	08	2.72	2.25	

* Computed from data on p. 390 below

reality because of the accumulation of a large German clearing debt Exactly the same incident was re-enacted in the summer of 1939, the same reason existed for the Brazilian action, and the same allegations reappeared in Germany¹ The abrupt cutting off of producers' outlets, illustrated in these cases, plays havoc with the economic calculations of the individual, puts production plans upon a hand-to-mouth basis, and adds to the inevitable *faux frais* of clearings²

The diversion of German cotton imports to Egypt and Brazil, in consequence of the necessity of employing clearing balances wherever they were available, was bound to produce unfavorable effects on the German textile industry, quite aside from the price of raw cotton The use of high quality, long staple Egyptian cotton for the coarse cotton fabrics produced for domestic consumption raised the cost of these textiles and led to a series of decrees fixing prices and restricting output³ Brazilian cotton was coarse and ill-adapted to the German textile machinery, and here again costs of production mounted German firms found themselves compelled, partly by economic necessity and partly by authoritarian action, to resort to domestic linen and rayon yarns⁴ Such shifts as these, in some cases to better and frequently to inferior qualities in textile manufacture, affect the cost of living If only better and more expensive qualities are available, or if the standard textiles undergo deterioration, an index of the cost of living based upon the previous grades conceals a real sinking of the standard of living As a result the almost horizontal course of this index for long periods together has to be taken with due reservations⁵

But the increased cost of production arising from technically or economically inappropriate grades of raw cotton pales into insignificance compared with the rise in import prices paid in bilateral trade On rare occasions direct quotations were made of free and clearing import prices Thus Egyptian cotton was quoted in October, 1936, at 105 6 Reichsmarks per 100 kg in free exchange and 125 0 Reichsmarks in barter, with corresponding

1 Reichskreditgesellschaft, Germany's Economic Situation at the Turn of 1938-1939, p 110

2 Cf E C D Rawlins, Economic Conditions in Germany, Department of Overseas Trade (London, 1936), p 123

3 Cf pp 205-206 above

4 Rawlins, op cit, pp 123-127

5 Cf Figure 23, p 210 above

figures for October, 1936, at 82.2 and 121.5 Reichsmarks.¹ However diametric such facts may be, actual quotations appeared so infrequently, especially as in this case for imports from a specified country, that we must proceed by the indirect method of dividing the published customs returns on total value of cotton imports from a particular country by the recorded volume. The results are shown in Table II, which serves as the basis for Tables III and IV.

In Table III, the average price paid by Germany for cotton imports is expressed in line five as a percentage of the world market price. It will be noted that, though this percentage is subject to ups and downs both before and after the institution of exchange control, the level about which variations occur is noticeably higher during the later period. This is true even with the data utilized in Table II, but the relative height of German import prices would be much greater in 1936 and 1937 if we were to employ the isolated data for these years supplied by the Dresdner Bank. The average import prices of 910 and 930 Reichsmarks for these years give relatives of 132 per cent and 107 per cent.

Of considerably greater significance is a comparison of the German import price for cotton from three typical clearing countries with the world market price for cotton from the same countries. For ease of comparison these prices have been expressed in Table IV as percentages of the current price on American cotton.

We perceive from Table IV the following: (a) The price for German imports of Egyptian cotton showed no tendency to follow the American price. Thus Germany had not only to purchase the more expensive grade of cotton but also to pay much more for it than countries purchasing outside the clearings on the world market.

(b) Cotton import prices from British India reveal the same non-competitive character. Having varied between 70 and 80 per cent of the American price until 1935, the Indian price sprang to a new level of 95–97 per cent for the next three years. The volume of cotton imports from British India, as we remarked before,² was maintained, and it was maintained in the teeth of paying the American price for an inferior grade of cotton. It is interesting, furthermore, to observe that, despite the discontinuance of compensation deals with India in 1937,³ the German import price for cotton remained stable. This seems to indicate clearly that, once trade

1 Reichskreditgesellschaft, Germany's Economic Situation at the Turn of 1937–1938, p. 50.

2 Cf. p. 247 above.

3 On February 24, 1937. Cf. R.E. 22/37, D St 10/37 Ue St.

GERMAN EXCHANGE CONTROL

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A DECADE OF GERMAN IMPORTS OF COTTON
II PRICE OF IMPORTED COTTON BY INDIVIDUAL COUNTRIES*

	(In Reichsmarks per metric ton)								
	1928	1929	1930	1931	1932	1933	1934	1935	1936
Egypt	2,507	2,416	1,858	1,265	946	918	872	998	1,104
British India	1,480	1,334	988	696	584	532	476	640	666
U S A	1,833	1,839	1,440	919	682	683	664	670	666
Turkey			1,321	884	759	753	845	1,006	905
Brazil	1,830	1,749	1,523	990	442		872	1,112	927
Argentina	2,038	1,976	1,526	939	674	752	735	945	902
Peru	1,961	2,316	1,571	1,075	811	793	807	1,023	1,074
Mexico	1,880	2,069	1,389				675	1,109	902
Average	1,719	1,709	1,340	886	686	649	651	830	793

* Computed from data on p. 390 below.

A DECADE OF GERMAN IMPORTS OF COTTON
III GERMAN IMPORT PRICE AND THE WORLD MARKET PRICE

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
1 Average German Import Price*										
(Rm per ton)	1,717	1,709	1,340	886	686	649	651	830	793†	787†
2 World Market Price (New York)‡	1,856	1,771	1,257	793	596	624	681	654	692§	865
3 Index of German Market Price	100	99.5	78.0	51.6	39.9	37.8	37.9	48.3	46.2	45.8
4 Index of World Market Price	100	95.4	67.7	42.7	32.1	33.6	36.7	35.2	37.3	46.6
5 1 as Percentage of 2	92.5	96.5	106.6	111.8	115.0	103.9	95.5	126.9	114.6	90.9

* Statistisches Jahrbuch für das Deutsche Reich.

† Concerning the 1936 and 1937 German import prices of p. 250 above.

‡ Reichskreditkasse, Germany's Economic Development in 1936 (Berlin 1937) p. 66.

§ Price in May 1936.

|| Price in April 1937.

||| Dresdner Bank. Stab 6 see Überichten der volkswirtschaftlichen Abteilung No. 11 (November 30 1938) p. 582 and No. 2 (February 28 1939).

A DECADE OF GERMAN IMPORTS OF COTTON
 IV GERMAN IMPORT PRICES AND WORLD MARKET PRICES AS
 PERCENTAGES OF THE AMERICAN (UNITED STATES) PRICE*

	1931	1932	1933	1934	1935	1936	1937
German Import Prices							
Egypt	137	136	134	131	148	165	159
British India	75	84	77	71	95	96	97
Brazil	107			131	165	151	140
World Market Prices							
United States	100.0	100	100	100	100	100	100
Egypt	141.1	142.2	110.3	109.2	114.7	118.8	127.2
British India	90.0	88.3	75.1	75.6	79.9	74.3	77.1
Brazil	101.3	104.8	98.8	95.5	96.8	93.7	91.5

* German import prices as given in Table II; world market prices from the Empire Cotton Review (Manchester England)

connections and channels of supply have been established under the auspices of clearing and compensation, it is not easy to turn to new sources. Not only the introduction but also the relaxation of exchange control entails costs, and these costs serve as obstacles to the removal of control. Ultimately, as Huhle says, the gain to the national economy would outweigh the costs of readjustment¹, but the elasticity of economic forces in international trade may be seriously impaired in an authoritarian regime, and the new sources of supply may be found only after delay.

(c) Brazilian cotton prices showed a decided falling tendency on world markets relatively to the price of the United States, finally arriving in 1937 at a margin only 8½ per cent lower, nevertheless Germany had to pay for Brazilian cotton in 1935, 1936, and 1937 prices which exceeded the American price by 65, 51, and 40 per cent.² It may be noted that the high price obtained from Germany for its cotton exports caused an artificial growth of cotton culture in Brazil (at the expense of other crops) and threatened a serious overproduction.³ From the German angle, in turn, there is little doubt that the impact of her own demand, falling upon new markets under the influence of bilateral trade, was one of the main

1. Fritz Huhle, "Das Clearingwesen," loc. cit., p. 205.

2. Brazilian coffee imports by Germany in 1934 and 1935 took place at prices rising from 63 Reichsmarks to 70 Reichsmarks per 100 kg., despite the decline of prices on world markets. Cf. Wirtschaftsdienst, Vol. 21, No. 1, p. 18.

3. E. M. Harvey and W. C. Bruzzone, Report on Economic and Commercial Conditions in Brazil, Department of Overseas Trade (London, October 17, 1937), p. 100.

reasons for the high import prices, not only from Brazil, but also from all the other countries covered in the tables, with the exception of the United States

(3) The Costs of German Imports of Copper The statistics of German imports by countries¹ have little significance for the present subject, save for the fact that imports from the United Kingdom nearly doubled from 1934 to 1935 under the influence primarily of the Anglo-German payment agreement of November, 1934.² The United States lost heavily in relative share throughout the period, not as a consequence of exchange control in Germany, but simply through the general decline of our copper exports in competition with the advent of effective exploitation of deposits in Rhodesia.³ Our interest centers rather in the behavior of German import prices. If we carry through the comparison of these prices, obtained by dividing the annual import volume by the annual import value,⁴ with the London price of *electrolytic* copper, as suggested in an analysis by the Reichskreditgesellschaft, we obtain the following rather surprising results

	1 Average German Import Price*	2 World Market Price†	3 1 as Percentage of 2
	(In Reichsmarks per metric ton)		
1928	1,269	1,397	90 8
1929	1,541	1,714	89 9
1930	1,187	1,248	95 1
1931	816	800	102 0
1932	546	527	103 6
1933	494	503	98 2
1934	423	417	101 4
1935	375	429	87 4
1936	449	522	86 0
1937	665	729	91 1

* Statistisches Jahrbuch für das Deutsche Reich

† London price of electrolytic copper from Metallgesellschaft Aktiengesellschaft Metal Statistics 1929-1938 (Frankfurt a/M, 1939) original series in old gold dollars converted to Reichsmarks (\$1.4198 Rm.)

The most striking aspect of these figures is the fall, in recent years, of the ratio of German import price relative to London price to levels *below* the pre-depression rates. But it is quite improbable

1 Cf p 391 below

2 Cf pp 213-219 above

3 For valuable suggestions concerning German imports of copper I am indebted to Mr Francis McIntyre of the Department of Economics, Indiana University. I am also indebted to Mr John S de Beers for the share of refined copper in German imports and the London price of electrolytic copper. His friendly criticisms caused me to relinquish the computations of the first published form of this work, and to revise the comparison of German import prices of copper with the world market.

4 Cf p 391 below

that Germany actually secured copper on more favorable terms than before 1929 such a situation would be unique amongst all imports for which there are data available, and it would be quite inexplicable. Furthermore, the semi-official source responsible for the data on p. 246 admitted that copper imported into Germany over the clearings cost more than copper imported over the free relations during two and one-quarter years out of the two and one-half years covered. We must assume, therefore, that in this case as in many others Germany was forced to turn increasingly to imports of inferior quality. This supposition is borne out fully by the factual evidence, which shows that the share of refined copper in the total of German copper imports declined from 91.2 per cent to a low point of 17.9 per cent in 1936. If we weight the London copper price according to the proportion of refined and standard copper in German imports in each year, we obtain figures differing substantially from those just considered.

A DECADE OF GERMAN IMPORTS OF COPPER
GERMAN IMPORT PRICES AND WORLD MARKET PRICES

1 Refined Copper as Percent of German Imports*	2 Price Margin in London between Standard and Refined Copper†	3 London Price Adjusted‡ in Rm per Metric Ton	4 Average German Import Prices§ in Rm per Metric Ton	5 4 as Percent- age of 3
1928	91.2	— 8.35	1,388	1,269
1929	76.9	— 11.29	1,669	1,541
1930	74.1	— 12.09	1,209	1,187
1931	66.2	— 10.72	771	816
1932	41.6	— 11.80	491	546
1933	43.8	— 11.40	471	494
1934	51.0	— 10.34	396	423
1935	25.2	— 10.58	395	375
1936	17.9	— 10.31	478	449
1937	29.8	— 9.16	682	665

* Computed from Metallgesellschaft Aktiengesellschaft Metal Statistics 1929-1938 (Frankfurt a/M 1939) mid month figures averaged

† The Statist (London)

‡ London price of refined copper as given on p. 253 above combined with the London price of standard copper as given in Col. 2 above according to the weights of Col. 1

§ As given on p. 253 above

These results seem to be considerably closer to the actual situation and they conform more closely to the figures on copper import prices for 1933 and 1934 as given by the Berlin Institute for Business Cycle Research. They show a stronger rise of German

import over the world market price than the figures on p 253 revealed, and they show no instance of the German import price at a ratio below the 1929 ratio to the world price. That the ratio fell below 100 in recent years is explained by an increasing unwillingness of copper exporting countries to take payment through the clearings. To the extent that this occurred, Germany paid high prices for her copper imports in a way not reflected in the quoted prices on copper effective payment in free foreign exchange entailed lower export prices on German goods sold upon world markets.

(4) Prices of German Imports of Wool Table I, showing the percentual share of individual exporting countries in Germany's total imports of wool, reveals in a very dramatic fashion the displacements in the channels of trade wrought by bilateralism. The share of Australia, traditionally the chief source of supply, fell from more than 30 per cent in 1931, to 11 percent in 1935. In 1935 the imports of New Zealand, which in the two years preceding had run above 10 per cent, suddenly dropped to 1½ per cent. This is accounted for by the German trade drive in Argentina, which advanced in German imports from 12 to 18 per cent, and in British South Africa, a region which fell under National Socialist political influence, from 11 to 21 per cent (in comparison with 1934). The same year (1935) also witnessed a doubling of wool imports from England as an entrepôt under pressure of the overvalued Mark rate and the payment agreement concluded at the end of 1934.

These shifts in supply were accompanied by import-price and quality changes directly ascribable to exchange control. In 1934 and 1935 import prices for the first time¹ rose above world market prices. In 1936 and 1937 the fall of the index is clearly ascribable to a substitution of cheaper grades of wool. So extreme was this shifting of quality that at one time the German demand for the inferior crossbred wool actually advanced its import price above the level of merino.²

1 Except for a smaller excess in 1930.

2 Fritz Huhle, "Das Kompensationsgeschäft in Rahmen der deutschen Handelspolitik," *Jahrbücher für Nationalökonomie und Statistik*, Vol 145, pp 206-207.

Mr C J Fawcett, General Manager of the National Wool Marketing Corporation (Boston), informs me that since Germany has used a large amount of "medium" and "defective" types of wool, an average price for German imports equal to the average London price would signify a substantially higher effective price for equal qualities.

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A DECADE OF GERMAN IMPORTS OF WOOL
I SHARES OF INDIVIDUAL EXPORTING COUNTRIES AS PERCENTAGE OF TOTAL GERMAN IMPORTS*

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
Belgium	4.60	4.82	4.66	6.16	4.93	4.64	4.04	3.73	2.85	3.00
France	4.90	4.83	4.54	5.85	6.85	6.76	4.68	4.25	3.02	6.52
United Kingdom	7.28	6.90	5.39	5.35	5.92	6.96	5.79	12.91	5.47	4.65
U.S.S.R.	0.68	0.56	1.54	3.20	2.87	2.00	2.76	1.46		
C.S.R.	1.53	1.74	1.89	1.45	0.91	0.90	1.75	0.50		
British South Africa	14.48	14.95	14.50	13.35	16.52	12.76	11.42	21.44	15.80	17.85
Argentina ¹	19.32	19.63	16.57	13.11	10.31	10.50	11.87	18.00	13.25	7.72
Australia	31.51	30.85	35.71	30.05	33.87	31.89	25.06	10.68	13.62	16.73
New Zealand	2.97	3.19	3.23	5.31	6.50	10.76	11.06	1.58	2.75	3.14
Uruguay	2.74	2.97	5.02	8.95	5.90	5.92	5.81	5.05	4.39	3.41
Chile	0.57	0.52	0.23	0.76	0.69	0.55	1.83	5.03	5.79	7.37
Peru	0.15	0.05					0.23	1.13	2.18	2.25
Brazil	0.68	0.92	1.42	1.38	0.59	0.87	0.93	3.36	5.53	2.98
Spain	0.38	0.23	0.21				0.19	0.63	0.87	4.30
Turkey							0.13	3.37	2.55	9.34
China	0.33	0.31	0.25				0.22	0.71	1.46	3.97
Total	100	100	100	100	100	100	100	100	100	100

* Computed from data on p. 395 below

II GERMAN IMPORT PRICE AND THE WORLD MARKET PRICE

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
1 Average German Import Price* (Rm per ton)	3,681	3,614	2,460	1,771	1,313	1,345	1,791	1,587	1,829	2,225
2 World Market† Price, London										
Mo. Average (Rm per ton)	5,179	3,963	2,432	2,098	1,486	1,788	1,666	1,486	1,835‡	2,256§
3 Index of German Import Price (1929 = 100)	100	98.2	67.0	48.0	35.9	36.6	48.5	43.1	49.7	60.5
4 Index of World Market Price (1928 = 100)	100	76.5	47.0	40.5	28.8	34.6	32.2	29.8	35.4	43.5
5 1 as Percentage of 2	71	91.5	101.1	84.4	89.0	75.6	107.5	107.0	100.0	99.0

* Statistisches Jahrbuch für das Deutsche Reich

† Reichsbankcreditgesellschaft, Germany's Economic Development in 1936 (Berlin 1937) p. 66

‡ Price in April 1936

§ Price in April 1937

Writing upon the National-Socialist Four-Year Plan, Professor Mackenroth of Kiel expressed the view that "foreign raw materials appear to be fantastically cheap"¹ If one were to fix attention exclusively on the overvalued Mark exchange rate, this would be the deduction. That this influence was more than counteracted by the combined effects of concealed devaluations and bilateralism seems to be amply attested by German import prices. We now turn to the question as to whether these losses in import prices were, as has been contended,² more than offset by high export prices.

B *German Clearings with Southeastern Europe*

When the Great Depression began to yield to belated recovery, the highly industrialized Germany was able — at the cost, it is true, of civil liberties and the further disruption of international economic relations — to build up a semi-insulated economy and to increase production and employment by tremendous strides. No such course was open to the agricultural countries of Southeastern Europe. Antiquated methods of production made them easy prey of American competition and the chief victims of agricultural depression. Migration to relieve overpopulation was barred by foreign restrictions, borrowing to carry through a rationalization of the productive apparatus was impossible in the shattered international capital market, and indeed, the burden of existing foreign indebtedness was so great as to delay resort to the necessary devaluations to make potential exports marketable. Furthermore, new industrial ventures, called into being in the post-war exuberance of nationalism, seemed to require the very protection which exchange control automatically affords.

This grave economic plight, coupled with a lack of gold and devisen reserves and a plethora of agricultural stocks held on government account, thrust these countries into clearing and compensation agreements and into the German bilateral trading system. Undoubtedly the Balkan countries and Germany embody the "natural" complementarity of agricultural and industrial countries, and this complementarity is furthered by geographic

1 G. Mackenroth, Bericht über den Vierjahresplan, Jahrbücher für Nationalökonomie und Statistik, Vol 148, No 6 (December, 1938)

2 Amongst others by Guillebaud op cit., pp 158-159, cf also p 269 below

proximity. But economic distances are not always proportional to miles; transportation by rail from Bulgaria, Greece, and Turkey to Germany is costly, the sea route circuitous, and Danube shipping limited in capacity. It is scarcely conceivable that German trade with this region would have developed as far as it did, had it not been for an evident resolution on the part of Germany to press her trade at all costs and to extend her sphere of economic and political influence.

(1) Bilateral Balance and Volume of Trade. During the year 1932 Germany concluded bilateral trading agreements with the six countries of Southeastern Europe with the avowed purpose of providing amortization of her outstanding credits to this region.¹ True to expectations, the balances of trade between Germany and each of these countries began to fall off, as shown in the table on page 102. Even in the next year the balances of three countries reached their minima for the decade 1929-1938 at a value close to zero, and in addition Hungary's balance — though slightly larger than in 1937 and 1938 — was almost negligible. The two remaining countries followed shortly with the German-Bulgarian balance at its minimum in 1935 and the German-Greek balance in 1936, in both cases at very small values.

How was this bilateral balancing achieved? Arithmetically there are three possible combinations: the "deficient" side (either exports or imports) could increase, the "excessive" side decrease, both sides could decrease, but the excessive side more, or both sides could increase, the deficient side more.² Two examples of each of these combinations happen to occur amongst the six countries under review. In trade with Rumania and Hungary, German exports and imports both declined to reach the approximate equality in the case of Rumania by a greater decrease of German imports, for Germany had had an unfavorable balance, in the case of Hungary by a greater decrease of German exports, for Germany's balance was favorable. In trade with Jugoslavia and Turkey, the deficient side from the German angle increased, the excessive side decreased with Jugoslavia, with which Germany had a favorable balance, German exports decreased and imports increased,

¹ Cf. pp. 201-202 above.

² From an arithmetic angle, two more combinations would appear if either side remained the same, and the other increased or decreased to equal it. Trade statistics would probably never show exports or imports exactly the same for two years, hence these combinations may be ignored.

GERMANY'S TRADE WITH SOUTHEASTERN EUROPE, 1929-1938*

	(In million Reichsmarks)									
	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
Bulgaria										
Imports	51.2	58.9	48.3	34.5	31.3	33.7	41.4	57.6	71.8	84.3
Exports	44.7	22.9	25.3	20.8	17.7	19.3	39.9	47.6	68.2	56.4
Balance	-6.5	-36.0	-23.0	-13.7	-13.6	-14.4	-1.5	-10.0	-3.6	-27.9
Greece										
Imports	103.7	108.1	70.3	58.9	53.4	55.3	58.5	68.4	76.4	93.6
Exports	76.8	56.3	56.6	23.5	18.7	29.3	49.1	63.5	113.1	111.1
Balance	-26.9	-51.8	-13.7	-35.4	-34.7	-26.0	-9.4	-4.9	+36.7	+17.5
Hungary										
Imports	89.3	82.1	55.2	36.4	34.2	63.9	77.9	93.4	114.1	109.7
Exports	146.8	118.3	84.4	47.4	38.1	39.6	62.9	83.0	110.5	110.0
Balance	+57.5	+36.2	+29.2	+11.0	+3.9	-24.3	-15.0	-10.4	-3.6	+0.3
Jugoslavia										
Imports	60.9	74.8	40.1	29.5	33.5	36.3	61.4	75.2	132.2	107.9
Exports	152.6	172.1	95.1	43.3	33.8	31.5	36.9	77.2	134.4	118.0
Balance	+91.7	+97.3	+55.0	+13.0	+0.3	-4.8	-24.5	+2.0	+2.2	+10.1
Romania										
Imports	211.0	236.9	102.4	74.4	46.1	59.0	79.9	92.3	179.5	140.4
Exports	164.1	137.3	92.5	64.2	46.0	50.9	63.8	103.6	129.5	148.8
Balance	-46.9	-99.6	-9.9	-10.2	-0.1	-8.1	-16.1	+11.3	-50.0	+8.4
Turkey										
Imports	75.6	69.0	52.6	40.1	37.9	67.5	93.4	118.5	97.8	116.0
Exports	72.5	48.3	47.4	31.0	36.3	50.9	67.3	79.4	111.1	151.4
Balance	-3.1	-20.7	-5.2	-9.1	-1.6	-16.6	-26.1	-39.1	+13.3	+35.4
Total Imports	591.7	629.8	368.9	273.8	236.4	315.7	412.5	505.4	671.8	651.9
Total Exports	657.5	555.2	401.3	230.2	190.6	221.5	319.9	454.3	666.8	695.7
Total Balance†	+65.8	-74.6	+32.4	-43.6	-45.8	-94.2	-92.6	-51.1	-5.0	+43.8

* Statistisches Jahrbuch für das Deutsche Reich Wirtschaft und Statistik, 1939, Vol. 19 No. 5, p. 177 (Old Reich)

with Turkey, with which Germany had an unfavorable balance, German imports decreased and exports increased. In trade with Bulgaria and Greece, German exports and imports both increased, in both cases, because the German balance was unfavorable, the balance was brought about by a more rapid increase of exports.

It has sometimes been said that bilateralism "causes exports to fall to the level of imports." This statement quite obviously errs in two respects, even if bilateralism is found to have a restrictive influence upon foreign trade. In the first place, such a restrictive influence requires only that the excessive item (*whether exports or imports*) should fall *more* than the deficient item rises, not "fall to the level" of the deficient item, or that the excessive item falls more than the deficient item *falls*. In the second place, bilateralism might have a restrictive *influence* and still not "cause" the foregoing conditions to be realized, if it were offset by other forces. What light is cast upon the *influence* of bilateralism by the behavior of Germany's balances with the six countries of Southeastern Europe?

Quite patently another factor of the first order of importance was operating along with bilateralism — the general course of depression and revival. Of the six cases of balancing, the two brought about by declines in both exports and imports by Germany come in the depression years of 1932–1933, and the two cases of balance by a growth of both items occur in the recovery subsequent to 1933. The two cases of balance by upward revision of the deficient side and downward revision of the excessive side come in the depression years, they include one case of a small increase of exports *plus* imports (Yugoslavia) and one case of a small decrease of total trade (Turkey). If the influence of bilateralism is downward, depression intensified its effects and revival sufficed to offset it, but if bilateralism had the opposite effect, the statistics could be interpreted as resulting from offsetting of its force by depression and an intensifying by revival. This inconclusiveness is augmented by the possibility of at least three other variables. Bilateralism constrains the flow of trade into new and unwonted channels, and realizes new points on the cost and demand functions in international trade, but these new *amounts* of supply and demand for some countries signify inevitably new *schedules* for other countries. We cannot know whether Southeastern Europe gained or lost from this process. In the second place, the extension of clearings tends, as

we have observed before,¹ to deflect an increasing share of the country's trade toward clearing partners. Over the years 1932-1933 the share of German total exports and total imports going to and coming from Southeastern Europe declined very slightly, but these were also the years of substantial German exports to Western Europe and America under the scrip and bond-repatriation devices. After 1933 the shares begin to increase, and 1934 does indeed seem to show the deflection of trade to clearing countries in a fair degree of isolation. The year 1935 marks the advent of a third variable, the German trade drive to the southeast. Whatever the influence of bilateralism *per se*, economic revival and the trade-drive combined to produce a decided upward-balancing of exports and imports. In retrospect we are unable to isolate the force of bilateralism. A concluding section on exchange control in Germany approaches the problem from a more inclusive basis — the general export and import "terms" for Germany, and a final theoretical chapter deals with the question upon an *a priori* basis supplemented by some empirical verification.

Within a short time after the accession of National Socialism to the government, the German economy — as we perceive more clearly today than then — was oriented toward a future war. The supply of imported raw material for this purpose came to be the Archimedean point of German commercial policy, a corollary of the slogan "Export or die." Prompted by the desire to buy from sellers who did not or could not demand payment in *devisen*, Germany began large purchases through her clearings with the Southeast. The exact time when the drive was launched differs amongst the several countries. The first clearing agreement with Turkey removed import quotas on German goods and provided for the payment of 30 per cent of the value of German exports in *devisen*, as a result, German exports to Turkey increased between 1933 and 1934 from 36.3 to 37.9 million Reichsmarks, with a parallel increase in German imports. For Hungary also, 1934 marked the beginning of strongly increased German trade, particularly of imports, but for Bulgaria, Yugoslavia and Rumania, it was rather 1935 which witnessed the opening of the German commercial campaign. We shall follow the main developments of this phenomenon in the six countries of Southeastern Europe, with

1 Cf p 121 and pp 223-224 above

especial emphasis upon Jugoslavia, for it can serve satisfactorily as a prototype for the action elsewhere

(2) Jugoslavia The prelude to the onslaught upon Jugoslavia was a commercial treaty of 1934, providing for the liquidation of a German credit balance of 100 million Dinars, and resulting in a substantial export surplus by Jugoslavia to Germany the next year. Earlier efforts to achieve this result by stimulating Jugoslavian exports of poultry, eggs, prunes, and other agricultural products had come to naught through German measures to protect her "peasant gentry" from foreign competition.¹ The beginning of German purchases was hailed with enthusiasm, the more so because of the League of Nations' sanctions being currently applied against Italy, which had furnished Jugoslavia with her most important export market. Germany was by no means tardy in taking over Italy's place by establishing purchasing agencies throughout the country. But the result of Germany's buying campaign was the accumulation of German debit balances in the clearing.² It may appear anomalous that the Jugoslavian favorable balance of 153 million Dinars in 1935 should have been accompanied by the rise of German clearing debts by 167 million Dinars. Clearing and trade balances need not correspond, however, inasmuch as the clearing included other items beside visibles and excluded trade "on terms." We shall see presently³ that Germany was able by a clever turn to derive marked advantages from the accumulation of clearing debts despite a really balanced trade. Apology has been offered for the accumulation of these debts on the basis that an agricultural country naturally piles up credits during the months following the harvest.⁴ Unfortunately for this thesis the largest single increase of Jugoslavian balances occurred in the first half of 1935. In any event, the prolongation of the waiting period bore with great severity on Jugoslavia, and for all countries of Southeastern Europe, poorly supplied as they were with working capital.

The initial enthusiasm for German purchases soon gave way to apprehensions concerning eventual payment. Transactions had

¹ H N Sturrock, Report on Economic and Commercial Conditions in Jugoslavia, Department of Overseas Trade, June, 1934 (London, 1934), p 24.

² In December, 1934, 223 million Dinars, April, 1935, 300 June, 1935, 260, September, 1935, 320, November, 1935, 362, December, 1935, 400.

³ Cf pp 264, 266, 267 below.

⁴ Royal Institute of International Affairs, Southeastern Europe, A Political and Economic Survey (London 1935), p 198.

been carried on at an official rate of 17.6 Dinars to the Mark, which admittedly overvalued the latter currency. The National Bank of Jugoslavia attempted to cope with the situation by permitting the sale of exporters' Mark-clearing bills at a four per cent discount, but the reduction of the German clearing debt in the summer of 1935 proved to be temporary. In November the discount was raised to 15 per cent, with a six-months waiting-period in the clearings for Jugoslavian exporters, this discount together with the loss of interest, clearing fees, and other costs in the clearing amounted to 30 per cent *per annum* and turned profits in most cases into losses.¹ Finally, in January, 1936, regular clearing was suspended in favor of something resembling the Austrian "private clearing" operating upon a ratio of 12.83-14.50 Dinars to one Mark. The return to a relatively true rate apparently rested upon a strengthening of Jugoslavia's bargaining position from the reopening of Italian markets.

This outcome was certainly at variance with German designs, for the very purpose of the high Mark rate had been to serve as the fulcrum to securing abundant imports. The Deutsche Volkswirt depicted the dangers to Jugoslavian exporters which would arise from a diversion of German purchases to other markets. That this journal admitted in the same connection a stimulus of German exports to Jugoslavia proceeding from the new exchange rate is a fact imbued with special significance in view of the bitter polemic launched a year later against the Viennese economist Richard von Strigl, who had asserted that artificial exchange rates are primarily responsible for one-sided accumulations on the clearings. By that time, however, the journal had so far reformed its opinions as to deny pointblank any connection between exchange rates and clearing balances.² Undoubtedly control of both exchange rate and domestic prices removes the connection obtaining when both are free to move, but it does not remove the influence of effective German export prices in comparison with those abroad, and that was what counted in the Jugoslavian, as in all other, clearing relations.

The introduction of the private-clearing rate worked toward equating payments, but its influence was confined naturally to

1 Frankfurter Zeitung, December 15, 1935.

2 Der deutsche Volkswirt, Vol. 10 (January 17, 1936), p. 709, Vol. 11 (June 11, 1937), pp. 1797-1798.

current items, and even here it was not adequate, so that in March, 1936, the German balance still continued to rise. During the next month Jugoslavia introduced an import control system in an effort to divert imports away from free-exchange countries and toward Germany and in May a joint conference at Zagreb agreed upon measures to promote imports, chiefly for public works and armaments, from Germany. On the difficult Jugoslavian terrain, Germany had succeeded in using the accumulated clearing-balances to coerce her partner into expanding bilateral trade with her at the expense of trade with free-exchange countries. The German clearing debt continued to be a chronic malady. The measures adopted by Jugoslavia in the early spring of 1936 resulted in a reduction from 465 million Dinars in March to 327 million Dinars in December, but an intensification of the buying drive swelled the figure to 415 million Dinars by March, 1937, despite these measures and despite occasional declines of the Mark rate in Dinars.¹ Various forms of intervention again reduced the German debt — to 177 million Dinars in December, 1937, but by the end of 1938 it had again increased greatly, reaching 400 million Dinars at the end of 1938.²

In order to give the German buying drive momentum, German export goods had been offered at low prices during the first year or two. But when German purchases had raised even the level of domestic prices in Jugoslavia, and when the limit of full employment began to be felt in Germany, the prices of export goods began to rise, not only overtly but also covertly in the deterioration of quality and in long delays in delivery. To offset these effects, German purchasing agencies offered to sell at incredibly generous "terms" with almost negligible down payments. By the middle of 1938 a dominant position was established for German electrical goods, bicycles, motorcycles, machinery and other important exports. The monopsonistic position which Germany had created for herself by clever exploitation of clearing agreements led to her having a monopoly in significant segments of her partner's market. Hitler's annexation of Austria and the Sudetenland augmented this dominating position, not only by virtue of Ger-

1 In March, 1937 the rate fell as low as 11.75 Dinars = 1 Mark, cf Sturrock, Report, July, 1938 (London, 1938), p. 12.

2 The source of the last figures on the German clearing debt is confidential.

many's incorporating the trade of these regions with Jugoslavia, but also by her acquisition of control over the foreign investments of these countries in Jugoslavia. Even more important was the growth of the political power of Germany, which could scarcely fail to menace the economic status of Southeastern Europe generally.

(3) Other Countries of Southeastern Europe. In Bulgaria, undoubtedly the poorest and most backward of the Balkan states,¹ German penetration met with least resistance. Compensation dealings were almost completely excluded and the Mark was maintained within 1-3 per cent of its official parity.² Characteristic of the degree of Bulgarian dependence was a secret provision of the Bulgarian-German clearing agreement providing not only for deliveries of goods of German origin but also of overseas imports into Germany, such as coffee and cotton. This was represented as a substantial concession to Bulgaria, but in fact it indicated the progress of isolating the country from world markets and incorporating it into the German *bloc*. The cost of this transformation appeared subsequently, when Bulgaria was obliged to pay 15, then 20, and later (1938) 25 per cent of her German imports in free foreign devizsen.³

In Turkey, Germany pursued her policy of outbidding all other foreign buyers with great persistence, offering margins as high as 60 per cent over world market levels.⁴ In 1935 and 1936 the favorable balance of Turkey in bilateral trade with Germany amounted to 56 million Reichsmarks, and by 1937 the German clearing debt had accumulated to such a magnitude (56 million Turkish pounds) that the National Bank refused any longer to discount exporters' bills on Germany. Why a country as impoverished for capital as Turkey should export capital to Germany by financing her imports for increasingly long periods can only be

1 The Bulgarian Business Cycle Research Institute reported in 1939 that 37 per cent of the 2,710,000 persons classified under agriculture actually represented "hidden unemployment." Cf Sudost Economist, Vol 1 (June 23, 1939), p 169.

2 Frankfurter Zeitung, September 16, 1935.

3 Cf T. Kalinov, "Bulgaria's Trade with Germany" in Stopanski Problemi, Vol 1 (October, 1936), p 378. The author ventured the prediction, corroborated by later developments, that the trade offensive of Germany would result in the establishment of a monopoly for her exports. (I am obliged to Dr Gerschenkron for examining this article.)

4 Economist, May 20, 1939, p 431.

explained on terms of economic and political pressure. The German claim that Germany exported capital to the Balkan countries because she sold capital goods there rested upon confusion or guile.¹ Where Germany extended long-period "terms" upon her exports, it frequently turned to the purchasing country's disadvantage, inasmuch as these sales increased the amount which Germany could import over the clearing, and which, because no payment was forthcoming, the clearing partner had to finance.²

The resistance of Turkey to German strategy met with varying success, but the long-run tendency was adverse. In August, 1937, a new clearing agreement set limits upon the extent to which 28 essential commodities could be exported to Germany. A year later a new agreement embodied further concessions on the German side — the 30 per cent payment in free devisen was abolished, and energetic steps were taken to increase exports from Germany. Through these measures the clearing balance was wiped out by October, 1938,³ but it began to accumulate anew and in the early months of 1939 reached a figure of eight million Turkish pounds.⁴ The autumn of 1938 marked the granting of a 12 million pounds sterling loan by Germany to Turkey to be expended in Germany for industrial and military equipment. The older device of pressure exerted through uncleared bilateral balances gave way to the more overtly political phase of Germany's predatory activities in the Southeast.⁵

German clearing with Greece was always transacted at the official rate of 40.5 Drachmas to the Mark.⁶ Tobacco exports

1 Cf J B Condliffe, *The Reconstruction of World Trade* (New York, 1940).

2 Cf Paul Einzig, *Bloodless Invasion. German Economic Penetration into the Danubian and Balkan States*, 2d ed. (London, 1939), pp. 36-46. While Einzig's work occasionally seems to overdraw the picture, it portrays the general character of the German tactics with verisimilitude.

3 A special feature of Germany's clearing trade, the reselling of the partner's products at low prices on the world market, in order to secure free devisen, was for some time widely applied to Turkish goods. By spoiling the market for her clearing partner, Germany increased the economic isolation of the country. In the Latin American trade examples of this sort can be multiplied, e.g. the case of Brazilian coffee purchases of Germany in 1937, none of which, it is said on good authority, arrived in Germany for home consumption.

4 In July, 1938, the German clearing account had a debit of 6.5 million pounds and the Turkish account a credit of 6.5 million pounds. But the agreement had not provided for cancellation, with the resulting calamity of uncleared balances and delay in payment on both sides.

5 *Economist*, Vol. 133 (November 19, 1938), pp. 361-362.

6 *Devisenarchiv*, Vol. 3, pp. 81-88.

account typically for half of the exports from Greece, and Germany purchased half the tobacco exports¹ As in Turkey, the National Bank financed the German clearing debt, when it reached 38 million Reichsmarks, the bank attempted to reduce its purchases of exporters' bills to 60 per cent But a storm of protest from the export interests forced the bank to the alternative of applying the accumulated Mark balances to German exports of supplies for public works and of armaments² This proved effective in reducing the German clearing debt to 9 2 million Reichsmarks at the end of 1937 and to virtually nothing at the end of 1938, but by September, 1939, it had again increased to 13 1 million Reichsmarks³ Greece was never able to reduce its purchases of German goods and had to confine attempts at improving the balance of payments by shutting off imports from other countries Under the influence of German demand, tobacco culture was expanded, the tobacco producers and exporters, as a result, always remained amenable to German dictation

Rumanian trade with Germany proceeded over the official rate of 55 Lei to the Mark until, in 1937, because of a strengthening of Rumania's position through the recovery of agricultural prices, she was able to reduce the rate to 38-39 Lei This rate recognized at least a part of the Mark depreciation, but was still high enough to make exports to Germany more profitable than to England⁴ Rumania's situation, as long as it turned upon economic matters, was always strongly supported by her petroleum resources She succeeded, for example, in limiting petroleum exports to Germany to 25 per cent of total exports in this bilateral relation, in resisting a German demand for the restoration of the 55 Lei rate towards the end of 1938, and in securing a compromise at 40 5-41 5 Lei⁵ The *coup de grâce* to Rumania's economic resistance was delivered by the German occupation of Czechoslovakia The agreement of March 23, 1939, went far toward subordinating the Rumanian to the German economy apart from large-scale buying of cereals, swine, and cattle, Germany secured 25 per cent of the oil production,

1 Economist, Vol 133 (December 3, 1938), p 479

2 S R Jordan, Report on Economic and Commercial Conditions in Greece, April, 1937, Department of Overseas Trade (London, 1937), pp 25-29

3 Jordon, Report, July, 1938 (London, 1938), p 23, and League of Nations, Balance of Payments 1938 (Geneva, 1939), p 61

4 Economist, Vol 134 (February 18, 1939), pp 349-350

5 Economist, Vol 133 (December 24, 1938), p 658

the abandonment of grain monoculture in favor of specific German needs, the re-direction of industry toward timber and oil processing, and finally the granting of free zones for German transit goods in the Danubian and Black Sea ports.¹ This agreement may be regarded as the pattern of German policy in Southeastern Europe in the period immediately preceding the outbreak of war.

(4) Conclusion It is beyond doubt that the panoply of devices employed by Germany in the five years from 1935 to 1938 had brought her to a position of economic dominance in her relations with Southeastern Europe, as may be read from the following statistics.

**GREATER GERMANY'S SHARE IN THE FOREIGN TRADE
OF SOUTHEASTERN EUROPE IN 1938***
(In percentages of each country's total exports and imports)

	Total	Old Reich	Austria	Czechoslovakia
Exports to Greater Germany				
Yugoslavia	50.1	32.5	6.9	10.7
Hungary	48.3	29.8	11.2	7.3
Rumana	48.3	35.2	4.7	8.4
Bulgaria	57.8	47.6	4.3	5.9
Greece	31.9	28.8	1.5	1.6
<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total	45.9	27.3	11.2	7.4
Imports from Greater Germany				
Yugoslavia	49.9	35.9	6.1	7.9
Hungary	50.1	27.7	18.2	4.2
Rumana	35.8	20.8	5.5	9.5
Bulgaria	63.4	51.8	7.0	4.6
Greece	43.1	38.5	1.7	2.9
<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total	46.6	32.1	8.4	6.1

* Reichskreditgesellschaft op cit (Berlin 1939) p 37

The triumphs celebrated by German commercial policy in the Balkans greatly exceeded even its successes in Latin America. A reference to the trade statistics² will show that German exports to South America remained as a rule far below the pre-crisis level. Only in the case of Brazil did German imports reach the level of

1 Reichskreditgesellschaft, Economic Conditions in Germany at the Middle of the Year 1939 (Berlin, 1939), pp 39-40

2 Cf pp 386-387 below

1929, in the Argentine trade they were 40 per cent below this level, even in the peak year of 1937

We have now completed a survey (in Section A) of German import prices and (in Section B) of her export prices. What is the evidence of the facts regarding the contention of Dr. Fritz Meyer, that

"if imports and exports are considered as a whole, then the relatively more expensive imports are offset by exports at relatively higher prices, because the other country has to agree to accept German goods and has to agree to limit herself in the choice of her supplies"¹

This seems to have been written with German trade developments and the exploitation of her clearing debts in Southeastern Europe as the *arrière-pensée*. It is not to be denied that high export prices did to a degree offset high import prices, but the extent of the offset is not altogether certain. As far as the German bids for supplying armaments are concerned, it is reported on good authority that the prices were actually lower than those of England and France. For imaginable reasons, Germany desired to supply the armaments, even if it involved loss. Exportation of this sort undoubtedly extended to other items than armaments, but Meyer gives no intimation of considerations other than economic in the German southeast trade. Furthermore, the process of attaching these countries to her own commercial system extended over several years, but the beginning had to be made through competitive prices on exports. A recent publication of the Royal Institute of Economic Affairs² observes that though export prices rose for the Danubian and Balkan countries after 1934 or 1935, there was no great rise of import prices. The statistical evidence advanced by the Institute does not prove to be altogether convincing,³ but it points to the danger of assuming that Germany obtained high export prices in all countries of Southeastern Europe equally and throughout the entire period.

If a net gain of export prices compared with import prices in trade with Southeastern Europe may be taken as real, though not as great as it appears superficially, there is small likelihood that the net gain in this segment of German trade could offset the high

1 Meyer, *op. cit.*, pp. 468-469

2 Royal Institute of Economic Affairs, *Southeastern Europe* (London, 1939), pp. 197-198

3 E.g. data are lacking regarding Greece, where Germany had marked success in obtaining high export prices

import prices which had to be paid elsewhere for purchases through the clearings German (old Reich) imports from this region did not exceed 11.9 per cent of her total imports in 1938, nor did exports amount to more than 13.2 per cent Outside Southeastern Europe Germany was not able in many instances to pile up adverse clearing balances and subsequently to exploit her debtor position Even the semi-official Berlin Institute for Business Cycle Research issued an express warning in 1937 that German clearing purchases do not automatically lead to an expansion of German exports, because "the foreign country cannot force her importers to buy German goods"¹ A tremendous effort was made by Germany in Southeastern Europe ingenious devices were applied, Bulgarians, Jugoslavians, Turks, Greeks, and Rumanians were bullied, cajoled, cheated, and lured into increasing their trade with the Reich, but the volume of trade did not in the end exceed that which had unobtrusively obtained in pre-depression days under freedom of payments For the prolongation of depression in Southeastern Europe, German exchange control itself bears a certain measure of responsibility, because of the key position occupied by that country in the foreign trade of the region So far as concerns Germany, was the game worth the candle? A subsequent review of her trading position will point to the likelihood of a net reduction in the "total gain" of foreign trade, despite a small and doubtful improvement in terms² The answer must be no, if we refrain, as Meyers did, from viewing exchange control as an instrument of political power

REVIEW AND APPRAISAL OF GERMAN EXCHANGE CONTROL

A Historical Summary

The bank failures in the summer of 1931 impinged upon a Germany demoralized from the War of 1914–1918, revolution, post-war inflation, the Versailles system of reparations, and perplexed by grave political strife The crisis in confidence struck upon an economy burdened with over 26 billion Reichsmarks in foreign debts, of which 16 billion was owed at short term Obviously the "liquidity" of a national economy within a short period has very narrow limits, and the actual transfer of three billion Reichsmarks of flight capital by the end of 1931 called for extraordinary

1 VzK, Vol 12 (December 30, 1937), pp 315–322

2 Cf pp 276–282 below

measures, particularly in view of the devaluation of sterling countries, which left German prices isolated from the necessary competitive level. Devaluation after the English pattern seemed to be precluded on several grounds, the most important being the danger of setting loose a flight from the currency. Assurance was given the public by proclaiming that the Reichsmark would be maintained at its old parity at all costs, and the Reichsbank was given monopoly powers in *devisen* dealings to put this resolution into effect.

From the early part of December, 1931, to the autumn of 1932 — perhaps even through the remaining months of 1932 — exchange control was viewed as a buffer, no longer a strictly short-term measure but still a transitional makeshift under which to carry through the necessary deflation for international equilibrium. The Fourth Emergency Decree of December 8, 1931, reduced interest rates, commodity prices, the salaries of civil servants, and wages generally. If it be granted that devaluation was psychologically and politically impossible, this was the only course for achieving international equilibrium. Several factors made it appear in 1932 that the policy might succeed: the renewal of the Standstill Agreement with more elastic terms, the Lausanne Conference, which virtually abandoned reparations, and the reorganization of the banks which had closed the previous summer.

The effort to attain price and exchange equilibrium was destined to failure. In competition with the sterling *bloc*, Germany rapidly lost her export capacity, and her favorable balance dwindled in 1932 to a third of its magnitude in 1931. The allocation of *devisen* at 50 per cent of the average imports by individual firms during the year preceding the imposition of exchange control did not go below the general shrinkage of production and demand for foreign products, and allocations appear on the whole to have been carried through without discrimination against particular types of imports. But discrimination was being practiced by Germany's trade partners, in the form of differential *devisen* allocations, quotas, special tariffs, and multiple exchange rates — all of which discouraged the effort toward international equilibrium. Furthermore, the rise of clearings made the effort seem superfluous, and Germany had already discovered the possibility of aiding exports through commandeering windfall profits made upon bond repatriations. Finally, the Bruning deflationary policy alienated the wage and salary classes, it invited a drive against trades unionism on the

part of industrial interests, and its adherence to the ideal of a liberal international trading system ran afoul of the growing protectionist and autarkic sentiments of industry and agriculture alike. The von Papen and von Schleicher governments inclined toward a reflationary policy. At first, in the decrees of September, 1932, establishing the tax-certificate scheme and rather limited public works, German economic policy represented an admixture of reflation with deflation, which persisted in wage-reduction bonuses. By December, von Schleicher had, however, turned to a more pretentious program of spending.

It would probably be more accurate to say that the Hitler regime, at least during the first eighteen months of its history, ignored rather than repudiated international price and exchange equilibrium. After its accession to power on January 30, 1933, the National Socialist government immediately set afoot a vigorous program of creating employment. The First and Second Reinhardt programs involved a frank avowal of an "autonomous economic policy"; thoughts of devaluation were banished, and exchange control was gradually accepted and then welcomed as a permanent complement to state powers over individual enterprise and consumption. As an exporter of industrial finished goods, Germany enjoyed a strongly favorable development in the terms of trade, and this circumstance permitted the continuance of the 50 per cent devisen allocation to February, 1934. Foreign devaluations meant that German exports could only be sold by subventions or by resort to partial devaluation through Sperrmarks. But the burden of debt, aside from the relief afforded through Germany's favorable terms of trade, was greatly reduced by foreign devaluations. Sterling devaluation accounted for over a billion Reichsmark reduction from the original Standstill debt of 6,300,-000,000 Reichsmarks, and the devaluation of the dollar subtracted a further half billion during 1933. Nevertheless the rapid expansion of credit in Germany in pursuance of the autonomous economic policy prevented the development of a favorable balance of trade necessary to maintain the debt service. A further breach in the system of international finance was made by the absolute Moratorium of July, 1934.

Western European creditor nations retaliated by the threat of compulsory clearings, but it is not to be imagined that the device was their invention, inasmuch as two years earlier Germany had

forced amortization quotas in clearings with her Eastern European debtors. During 1933 and 1934 German wholesale prices rose from 66 to 73 per cent and sensitive prices from 41 to 50 per cent, while prices in England continued to decline. This price differential, together with the use of "Swedish clause" clearings for imports from third countries, produced an unfavorable balance of trade for 1934, piled up large adverse clearing balances, and necessitated the reduction of *devisen* allocations by successive stages from March to August from 45 per cent to five per cent. The exchange control authorities strove against this development by tightening the Mark allowances of travellers and emigrés, and by establishing *Überwachungsstellen* for textiles, nonferrous metals, cowhides, and rubber — the first introduction of direct qualitative control of foreign trade.

The solution elaborated by Schacht for the trade *impasse* of 1934 was the principle that no import payment should be allocated by the Reichsbank unless the import had been approved by an *Überwachungsstelle*. Further essentials of the New Plan were the reduction of imports of finished goods and of exports of raw materials, the increase of exports to overseas suppliers of essential raw materials, and the restoration of a favorable trade balance. Subsequent developments proved that "the New Plan accomplished the main purpose for which it has been called into being," as Guillebaud maintains,¹ indeed all of these purposes. But, as he adds, this "improvement" was partly achieved through restricting total imports, so that their value in 1936 remained substantially below the trough of depression in 1933 and 1934. The import restriction came as the result of a vigorous extension of the German clearing system throughout South America and Southeastern Europe during 1935–1937. The character of German exchange control underwent no really significant changes thereafter, and even the present war required no fundamental recasting.² For a time during the latter part of 1934 and 1935 it seemed that the Aski Marks would permit the formation of an officially tolerated free market in German exchange, but the severe limitations imposed between 1935 and 1937 upon exports to which Aski Marks could be applied, and the successive narrowing of the fraction of the purchase price which could be paid in these Marks, revealed a firm

1 Guillebaud, *op cit.*, p. 99.

2 *Economist*, Vol. 138 (May 4, 1940), p. 815.

intention of the authorities to maintain direct and arbitrary control of supply and demand forces and the rates of all varieties of Sperrmarks. Similarly the payment agreements, exemplified by the Anglo-German arrangement, betokened no real departure from clearing, despite the use of effective *devisen* payments, since the exports of the two countries were constrained by direct interference to conform to a pre-determined ratio at the official rate on Reichsmarks.

B Volume, Direction, and Composition of Trade

As shown in Fig. 24 (p. 224), the introduction of exchange control in mid-1931 started German exports, expressed as a share of world exports, on a downward course which persisted into 1934, while imports, as a share of world imports, rose to the same turning point. This method of expressing exports and imports eliminates the factor of world depression and leaves as a residual those factors peculiar to Germany. Since the terms of trade for Germany rose in depression, it is difficult to ascribe the adverse development to other circumstances than exchange control, especially the adherence to bilateralism. After 1934 exports slowly increased, but did not exceed 10 per cent of world exports in 1938 compared with 12 per cent in 1929. The New Plan throttled imports in 1936 to the share of world imports (at slightly over 7½ per cent) which they had assumed in 1931, thereafter the German recovery increased imports more rapidly than exports, and, though Germany may be said to be a typically export surplus economy, the favourable balance was not as large in the full-employment years 1937 and 1938 as it had been in the bottom of depression in 1933. If the "Greater Germany" of 1938 and early 1939 is considered, the balance of trade in these years was adverse and to a greater extent even than in 1934.¹

A striking change in direction of German trade was its transfer from Western Europe to overseas and Southeastern Europe. Exchange control and other interferences such as quotas and import prohibitions reduced the Western European share of imports from 23·2 per cent in 1931 to 20·6 per cent in 1932. For four years, the figure remained at 20 per cent, but the New Plan and its drive to pay for overseas raw materials by exporting to these countries

¹ Cf. p. 380 below.

reduced the percentage through 1936, 1937, and 1938 to 16.9 per cent. The share of exports to Western Europe hovered about 40 per cent from 1931 to 1934, but again, in response to the scheme of strict bilateralism this share of exports declined strongly from 1935 through 1938 to 27.5 per cent.¹ Thus clearing and compensation forced German trade to more distant markets on both the export and import sides, with an inevitable rise in the net cost of imports, a cost which is technical in character, separable from the rates of exchange involved in clearings. Approximately the same relative changes in the proportion of German exports and imports obtain, if to the five countries of Western Europe (Great Britain, France, Belgium, Netherlands, and Switzerland) there are added Sweden and the United States to complete the list of the chief creditors of Germany.² Despite the liquidation of frozen credits in Germany by the application of these depreciated accounts to exports, the pressure of bilateralism carried German trade toward South America and the Danubian and Balkan states. If we compare the shares of German trade with Europe as a whole and with the rest of the world,³ we discover that the former declined from 1935 through 1938 from 61.6 to 54.5 per cent on the import side, and from 1931 through 1938 from 81 to 69 per cent on the side of exports. The bilateralism of clearings is chiefly responsible for the change from 1929, when an export surplus of 2,857,000,000 Reichsmarks to Europe paid for an import surplus of 2,821,800 Reichsmarks outside Europe, to 1938, when these figures amounted to no more than 698,700 Reichsmarks and 901,700 Reichsmarks, respectively. The greatest change in direction of German trade is given by the combination of bilateralism and autarky, both of which moved German trade away from the predominantly industrial countries — Austria, Belgium, Czechoslovakia, France, Great Britain, Italy, Japan, Luxembourg, the United States, and Switzerland. From 1931 to 1937 German imports from these countries fell from 39.1 to 27.8 per cent of total imports, and German exports from 48.4 to 36.9 per cent.⁴

From the viewpoint of changes in the composition of trade,

1 Cf p 383 below

2 Cf p 384 below

3 Cf p 385 below

4 Cf p 389 below. It is impossible to carry the comparison into 1938, because of the incorporation of two of the industrial countries, Austria and the Sudeten part of Czechoslovakia, into Germany itself.

Germany shows the characteristic pattern of a state tending toward autarky. If we draw a comparison between foodstuffs and industrial products, and subdivide the latter according to degree of fabrication, we discover the following changes. Amongst industrial imports, raw materials rose from 27.2 per cent of total imports in 1931 to 33.9 per cent in 1938, whereas finished products fell from 14.4 to 7.3 per cent, or to half their share before exchange control. Cyclical forces predominate in the import of foodstuffs, but their share — it is worth observing in passing — did not recover in 1938 to the pre-crisis level. The export of foodstuffs, never an important item for Germany, declined from 5.0 per cent to 1.2 per cent, exports of raw and semifinished industrial products shrank slightly, but the share of finished industrial exports rose from 72.4 per cent to 81.5 per cent.¹

C Terms and "Gain" of International Trade

The inquiry into volume, direction, and composition of trade would be as dull as the foregoing statistical synopsis were not the whole matter illuminated by the intriguing question, Did Germany gain or lose in international trade through exchange control? Undoubtedly the imperfections of statistical data prevent a precise quantitative answer to this crucial problem, but I do not believe they prevent an answer altogether.

Aside from the prevention of flight psychology, the main purpose of retaining the old gold Reichsmark and the exchange control apparatus which it implied was to sustain Germany's terms of trade, both on current account and in payment of past obligations. The acceptance of this goal implies, of course, that the advantage in terms of trade offsets the possible loss in volume of trade, so that the result of multiplying terms of trade by volume would be greater than otherwise, that is, that the so-called "total gain"² would be larger under exchange control (including not only overvaluation of the currency unit but also discrimination between buyers) than under free payments and devaluation. It has already been suggested that a comparison of the terms of trade for Germany and for England give a clue to the effect of the overvaluation of the Mark.³

1 Cf pp 381-382 below

2 Cf Jacob Viner, *Studies in the Theory of International Trade* (New York, 1937), p 563

3 Cf pp 335-342 above

Let us pursue this analytical method further. Examine first the index of terms for England in comparison with the German index, as given in columns two and one in the accompanying table.

INDICES OF GERMAN AND ENGLISH TERMS OF TRADE AND THE
OVERVALUATION OF THE REICHSMARK

	German Terms of Trade*	English Terms of Trade*	Excess of German over English Terms	Excess of German over English Wholesale Prices (Gold)†
1929	100	100	0	
1930	108.2	106.1	2.1	
1931	123.8	115.7	8.1	11-43
1932	144.4	115.5	28.9	38-50
1933	142.8	119.9	22.9	46-57
1934	135.9	118.8	17.1	60-77
1935	126.3	115.3	9.0	67-78
1936	122.0	112.6	9.4	59-69
1937	117.6	108.0	9.6	44-57
1938	128.8	114.7	14.1	61-86

* For source cf. p. 379 below.

† Minimum and maximum quarterly averages within each year.

Both countries gained absolutely in terms of trade by virtue of their predominantly industrial exports, but from 1931 the German terms were appreciably higher than the British, the margin being shown in column 3. It is quite apparent from these data that variations of the German index of terms relatively to the British relate closely to the overvaluation of the Reichsmark. The great increase of the German margin comes in 1932 with first annual trade statistics after the introduction of exchange control in Germany. The reduction in this margin in the next few years follows logically from the extension of use of export subsidies of devalued Marks in the clearings and *Sperr* categories. Other factors might indeed affect the relative terms of trade for the two countries — most notably changes in international demand and in capital movements. Whatever influence the demand factor may have had, it is clearly quite subordinate to the Mark currency factor, and the separate influence of capital movements, also subordinate by the evidence of the 1931 figures, will be taken account of later.

Proceed now to a comparison of movements of the German terms of trade with a simple purchasing-power-parity measure of the underlying overvaluation of the Reichsmark (column 4), which is useful as an indicator of German costs of production.

relatively to costs in the free-currency economies such as the sterling *bloc* and more specifically England. The German positive margin is a mere fraction of the overvaluation, ranging from two-thirds at a maximum in 1931 to one-eighth at a minimum in 1935, typically closer to the latter than to the former limit.

Why should the extensive overvaluation of the Mark produce so small improvement in the German terms of trade? The primary cause, in all probability, is the practice of exporting over depreciated Mark categories and by means of subsidies. The probability would be a certainty if we knew that the German official export-price index represented prices net of these aids. But the probability amounts to a practical certainty. Our previous investigation of overvaluation of the Reichsmark¹ revealed that export prices articulate quite smoothly in the margin between subsidy per unit of export and domestic wholesale prices. It would furthermore be the natural bargaining strategy of exchange control authorities to quote the lower figure, i.e. the price after subtraction of various export aids. A second and very important cause of the relatively small advantage in terms of trade was the high cost of imports. Germany regularly paid prices in clearing, compensation, and Aski deals which considerably exceeded world prices, because of the necessity of buying within the confines of bilateral balancing, as an earlier analysis has shown.² Since bilateralism was a consequence of exchange control (including overvaluation), so too was the reduction of the improvement in terms of trade, ascribable to import costs. As a specific example, German import prices, after having moved along the same level with the British index from 1929 to 1931, exceeded it by 2½ per cent in 1931 and by successively wider margins to eight per cent in 1938.³ Nevertheless, despite its small magnitude relatively to Reichsmark overvaluation, the combination of the artificially high rate of exchange and the use of discriminating *sub rosa* devaluations apparently gave Germany more favorable terms than England's.

To complete the argument as to total gain, it is necessary to move to the second term of the multiplication, that is, to the volume of trade. A favorable change in terms could be attended with a fall in total gain if volume decreased sufficiently. But it is

1 Cf p 233 above

2 Cf pp 242-247 above

3 Cf p 379 below

unfortunately impossible to use physical volume directly, because of the very changes in the exchange-control period in composition of exports and imports which we have just reviewed. Changes in total value of exports and imports are taken in a substitute rôle for volume, and in order to avoid the cumbersome expressions of actual magnitudes, they are expressed in percentages of world exports and imports. Percentages are also used in comparisons with the value of exports and imports of Great Britain, a country of predominantly industrial exports as is Germany.

At first consideration, this method is apt to yield conclusions very favorable to the German exchange control. In 1932 and 1933, the years of highest German barter terms relatively to the British, German exports were 107 per cent and 95 per cent of British exports in the two years respectively, whereas in 1935, the year of lowest German terms relatively to the British, German exports were only 82 per cent of British exports.¹ German imports showed no change relatively to imports to England. It appears that despite exacting higher barter terms in the first two years, Germany increased its export position relatively to the free-payments devalued-currency England. Germany both ate and had its cake. In 1935 the lower barter terms were accompanied by a relative deterioration in export position. Germany lost both the cake and the eating.² The same conclusion could be drawn in the English comparison, though with less striking extremes, as between any year from 1931 through 1933, on the one hand, and any year from 1934 through 1937, on the other. If the basis of comparison is shifted to world trade,³ the general relations for the same groups of years with their accompanying indices of trade terms are not changed.

It is no mere academic exercise to construct such an argument,

1 For a statistical summary of these relations through 1929-1937, cf. the table on p. 277 above in conjunction with the figures on p. 379 below. The changes of the German territorial area in 1938 and 1939 interfere with comparisons in these years.

2 It might be imagined that just the opposite interpretation could be made. 1932 and 1933 represent bad years, since Germany paid a large volume of exports for small volume of imports — what Taussig calls the "gross barter terms of trade" had declined. But this ignores (1) that the barter terms were in fact relatively favorable, (2) that the magnitudes under comparison are not physical volume of exports and imports, but total values. Since the balance of payments balances, the residual from the visible trade must appear in the capital items, upon their behavior in the German situation much depends, as will presently become apparent.

3 Cf. statistics on Germany's share of world trade, p. 393 below.

for German exchange control does not lack its advocates precisely upon the basis of total gain of foreign trade, both within the country and abroad.¹ But the argument is based upon a notorious *non causa pro causa*. Because relatively favorable terms attended improvements in Germany's relative export position, the former is assumed to be the cause of the latter. But this is to ignore the one most conspicuous phenomenon of Germany's international situation from 1931 through 1933 — the export of capital. The violent effort of foreigners and nationals to transfer wealth in both monetary and real form abroad caused the "favorable" balance, this balance developed *not because* of the favorable German terms of trade, but *despite* them. From July, 1930, to February, 1934, German foreign indebtedness decreased from 26.8 to 13.9 billion Reichsmarks, and this was a period of the "favorable" showing on the basis of export position and terms, from February, 1934, to February, 1938, foreign debts declined only from 12.9 to 10.0 billion Reichsmarks, and this was the period of the less favorable aspect of exports and terms.² In the first three and a half years debts fell by around 13 billion, in the second four-year period by four billion Reichsmarks. Devaluations, it is true, accounted for a relatively larger share of the debt reduction before 1934 than after, but the offset is not sufficient to matter seriously in the present context.³

As far, then, as we are able to trust the evidence given by a comparison of German terms of trade with developments in a single foreign country, there appears to be no ground for supposing that the relatively high level of the German terms had itself any discoverable tendency to increase the relative import and export position of Germany in world trade or, by the same token, the "total gain" of her foreign trade. Limitation of the comparison to the English terms does, indeed, leave much to be desired, but it is impossible to find another significant industrial country which did not undergo devaluation within the period of German exchange control, making it eligible for comparison. Furthermore, export and import price indices have to be accepted with some caution.

It must be emphasized, however, that the preceding calculations have accepted the official German index of export and import prices without question, but that there are two important offsets

1 This issue will recur in the concluding chapter.

2 Cf. pp. 231, 277 above.

3 Cf. p. 288 below.

These offsets reduce the "total gain" substantially from a genuinely economic angle. In the first place, we may be certain that nothing is allowed in the report of net export prices for two impressive sets of costs: the first, interest and risk costs involved in taking payment through the lagging and uncertain process of clearing and compensation; the second, the entire weight of administrative costs of exchange control upon the state budget and the taxpayer.¹ In the second place, however, the net terms of trade really stood in the German case, they were more favorable in any event than exchange control as a mere *economic* device would have given. Our investigation of German exports through clearings with Southeastern European countries disclosed that German goods were frequently sold, to put the matter mildly, at higher prices than competitive conditions could explain. In part, the high prices proceeded from regional quasi-monopolies on the part of Germany. But in part, they arose from her adroitness in exploiting her debtor position in the clearing accounts, and in part, they rested on political might and hard bargaining.

In concluding the subject of the German "total gain" from foreign trade, I should like to remark that no more easy method of analysis exists than the laborious calculus of terms and volume, and the making of allowances for capital movements, concealed costs, and other relevant but complicating factors. A mere appeal to the generalization that authoritarian interference with the operation of comparative costs is bound to reduce the net yield of foreign trade does not suffice. The principle of comparative costs looks aside from discriminating monopoly, but this is one of the chief phenomena which admit the theoretical possibility of greater total gain with exchange control than without. But if exports and imports are accurately reported, both as to price and volume, the total gain is implicit in the data. The same must be said with regard to a shift of trade to more distant markets: discriminating monopoly might still make the trade more profitable, and if so, accurate statistics of price and volume would reveal the fact.

Furthermore, it is impossible to test the economic efficiency of the German international trading system by the movement of the cost of living or real wages in Germany. Evidence is indeed not wanting that the official cost of living index concealed qualitative

1. For Germany there has never been the slightest breach in the secrecy surrounding the costs of administering exchange control.

deterioration in the standard of life and a decline in real wages¹. In a competitive or free-enterprise economy, the debasement of real consumer income would be damaging evidence concerning general effectiveness of its production, including the yield of foreign trade. In a totalitarian society in which an avowed aim was to divert most of the increased social dividend from consumption to capital goods and rearmament, the test fails. We therefore have to analyze the total gain of foreign trade directly in its components, terms and volume, as in the preceding paragraphs.

D Conclusions

As these concluding pages are being written, Germany is astounding and dismayng the world with her military might. A danger exists that this military prowess be taken as a vindication of Germany's entire economic apparatus. Since exchange control is accepted by its authors as part of this apparatus, the sanction may extend to this particular phase of the German economy. The question becomes significant in these circumstances whether German exchange control through the eight years of its *ante bellum* history proved to be an effective institution, and for what it was effective. In brief compass, what have been the findings of the present investigation? The retrospect profitably includes the results of German exchange control respecting the monetary standard, the character of foreign trade, the terms and total gain of foreign trade and the foreign debts, as well as conclusions regarding the control as a new system, and its connection with the totalitarian state.

As long as the bulk of Germany's international trade and payments actually passed at the official Reichsbank rate of exchange, and as long as the panic following the summer crisis of 1931 lasted, German exchange control may be adjudged a success in thwarting an economically purposeless capital flight and in preserving the integrity of the national monetary standard. The justification of the maintenance of the Mark parity persisted only to the juncture when devaluation became practicable, and the justification of the various devices to prevent a capital outflow persisted only to the

¹ Cf International Labor Office, Employment, Wages, and International Trade (Geneva, 1940), Appendix II, Incomes of German Workers, pp 95-103, Balogh, op cit, pp 466-467, 482, 495, Guillebaud, op cit, pp 186, 206, 208-209, 211, Poole, op cit, pp 221-222, Fritz Sternberg, "Why Isn't Germany Bankrupt?", New Republic, Vol 102, No 22 (May 27, 1940), pp 717-719.

time when satisfactory arrangements had been made with foreign creditors. It is, of course, impossible to designate a precise time at which these conditions were fulfilled. Devaluation immediately following the English action in September, 1931, would probably have been a hazardous venture, because of a possible flight from the currency.¹ By the summer of 1933 the case for devaluation was strong, though not perfect. A great deal of German trade already proceeded over *de facto* devalued rates, the capital flight was under control, debt service had proceeded satisfactorily, and there were clear signs of economic recovery in Western Europe. Dollar devaluation still in process represented the one great obstacle, because of its uncertain extent. Had Germany devalued *par passu* with the United States, however, the probabilities are strong that the American move, instead of imposing downward price adjustments on the gold *bloc*, would have induced the alternative adjustment of rising prices and economic expansion, both at home and abroad. It must not be forgotten that even before the economic expansion program of the National Socialist government had got under way, Germany held a key position in the economy of Central Europe. So far as concerns foreign debts, the situation was even more favorable. Reparations had been virtually annulled in the Lausanne Conference a year earlier, and the Standstill agreements had provided fairly adaptable *modus operandi* for short-term debt. After 1933 it is difficult to discover justification for exchange control as a monetary and financial measure, its aims became "ulterior."²

If the case for devaluation was strong by 1933, it was ironclad in 1934 and 1935, and the "justification" of exchange control had to be shifted completely from monetary and financial matters. By the middle of 1935 Austria had pioneered the way to an equilibrium adjustment of the Schilling and had liberated payments except for capital flight purposes. Foreign indebtedness *per capita* had been as heavy as Germany's, unemployment more severe, and the general economy much weaker through territorial losses and the absence of an industrial rationalization movement in the 'twenties. In refusing to follow the course of Austria in 1934 and 1935, Germany not only sealed the fate of her gold *bloc* neighbors, which in general had not followed an "autonomous-economic" or credit-expansion policy such as to make currency depreciation

1 Cf pp 172-173 above

2 Cf pp 228-233 above

inevitable, Germany also accepted as a prospectively permanent institution a fictitious currency unit which imposed the necessity of multifarious *ad hoc* but concealed devaluations. Inflation has its counterpart in a controlled economy, so far as concerns both foreign and domestic trade, in shortages and rationing. Prices do not rise, but this is not the only way in which it is possible to "get less for your money." In the field of imports, devisen are rationed out, and thereby from the angle of the economy as a whole imported goods are also rationed¹; in the field of domestic goods, individuals see the rationing directly. In both cases money buys less, and this is the meaning of monetary depreciation. It is in vain, therefore, that German writers protested that the Reichsmark did not depreciate,² for the rationing of imports to German consumers as a group and of domestic goods to German consumers of specific commodities bore directly upon the holders of Reichsmarks, not the holders of the special *Sperr* varieties. Exchange control failed of its purpose in maintaining the integrity of the currency unit. So far as concerns the flight of capital, a direct embargo without the other apparatus of exchange control — official rate, rationing of devisen, and bilateralism — would have served as well, for it would have used the same devices as did the control authorities. Exchange control from the monetary and financial angles was superfluous as early as 1933 in all probability, but by 1935 for a certainty. We must turn thereafter to the "ulterior" ends.

Analysis of German trade reveals that, in all respects save the doubtful issue of "total gain," exchange control produced results which were not only ulterior to its avowed monetary and financial aims, but more significantly, ulterior to any economic calculus. Schacht's New Plan ostensibly introduced the altogether unexceptionable principle of refusing to permit imports for which the means of payment were lacking.³ In fact, it ushered in the complete

1 During the period of devisen allocation on a percentual basis, from the autumn of 1931 to the autumn of 1934, the rationing was indeed explicit; thereafter it was only implicit but undoubtedly present in the limitation of imports through *Überwachungsstellen* decisions as to what was an "essential" foreign purchase.

2 E.g. Rudolf Eicke, *Warum Aussenhandel* (Berlin, 1936), *passim*, Carl-Hermann Muller, *op. cit.*, p. 326.

3 As well informed a critic as Heuser apparently fell victim to German propaganda upon this matter, in pronouncing the New Plan to be "a step in the right direction," of Heinrich Heuser, *Control of International Trade* (London, 1939), p. 133.

authoritarian control of what should be imported and what exported, in what quantities, for what means of payment, at what prices, and with what countries. Thereby exchange control became a misnomer, for it really signified foreign trade control. The exchanges were allowed to fend for themselves in the *sub rosa* *Sperrmark* categories, or determined *ad hoc* upon the grounds of temporary expediency in trade negotiations with clearing partners. As for foreign trade, the phenomena against which the control was directed were production for export on the basis of relative costs and the maximization of profits, on the one hand, and consumption on the basis of relative prices and the maximization of utility by free choice on the other. Political aims engulfed the economic calculus. There is no denying, of course, that the extension of employment not only supplied one of the main objectives of the National Socialist "autonomous economic policy" but also that it represented one of its actual accomplishments. A theoretical possibility does exist that protectionist measures may, with specific international demand and cost functions, extend the volume of home employment, at least for the short run. None of the proponents of this theoretical position, however, have had the hardihood to suggest that protection is best achieved through the panoply of exchange control devices — overvaluation, differential *de facto* devaluations, and bilateralism. Reemployment necessitates no exception to the statement that, with the possible exception of the terms of trade, German exchange control can be explained after the first two years of its history only in non-economic terms.

The non-economic character of international trade under German exchange control appears in its volume, direction, and composition. The point may be raised that no matter what violent alterations may have come about in the character of German international trade in the change from a liberal to a totalitarian system, the question whether these changes were economic (i.e. governed by a calculus of relative costs and pecuniary profit) or not is answered solely by findings as to "total gain" (terms multiplied by volume). Such a contention would ignore the announced aims of German trade policy and the realization, in part at least, of these aims in the actual course of trade. Neither the aims nor the actual developments correspond to economic criteria. As we have seen,¹ the New Plan was oriented toward reduced imports and increased

1 Cf pp 211-212 above

exports of finished goods during the National Socialist regime imports of this sort decreased from 12 per cent to seven per cent of the total and exports increased from 72 per cent to 82 per cent. Both aim and accomplishment defy the comparative cost principle. Another aim was the transference of industrial exports from European to South American and other overseas markets; here again a distinct shift in actual trade responded to the effort. Not the higher prices of the overseas markets but the maintenance of bilateralism — without which exchange control under an artificial rate cannot function — explained these facts. The New Plan set as another goal the enlargement of the favorable trade balance, and the years 1935–1937 saw an improvement over 1934. Not by the extension of exports through competitive advantage, however, but by the restriction of imports through the direct interference of *Überwachungsstellen*. As Piatier points out,¹ the temper of German trade policy is well revealed in an article of *Die Bank* of March, 1936, enumerating the major items of import and describing ways in which Germany might hope to dispense with three-fourths the going volume of foreign purchases. Such examples — and the list might be extended indefinitely — do not bespeak a preoccupation with some grand economic end to which the examples are subordinate details. They are the components of autarky, which negates the economic calculus of costs and productivity.

Throughout the exchange-control period from 1931 through 1939, Germany enjoyed relatively high terms of international trade (export prices as percentages of import prices) and may have benefited from an increase in "total gain." The largest part of the advantage in terms is clearly ascribable to the high ratio of industrial to agricultural prices during depression and the marked predominance of the former in German exports. The analysis of German terms relatively to England, likewise a country of industrial exports, showed² that the apparent margin in terms secured by the overvaluation of the Mark was a relatively small fraction, varying between two-thirds and one-eighth and generally closer to the latter limit, of the overvaluation. Responsibility for this rested, first, upon the gradual resort to devalued *Sperrmark* rates and subsidies for exports and, second, upon the high import prices which, as

1 André Piatier, *Le contrôle des devises dans l'économie du III^e Reich* (Paris, 1937), p. 130.

2 Cf pp. 276–282 above.

we discovered in the section on this subject,¹ attended German purchases through the clearings. But the relatively favorable terms of trade cannot even be taken — small as the advantage is — at their face value, since substantial reductions have to be made for two sources of concealed cost — losses to exporters through risk, delay, and technical costs of operating through clearings and compensation, and the administrative costs to the State of exchange control.² If we are interested in the economics of the German trade terms, we are bound also to record that the relatively high export prices secured in German clearings, with Southeastern Europe especially, are less ascribable to extensive and inelastic demand for German products than they are to chicanery, exploitation of Germany's debtor position, and political pressure.³

If the case for a genuine economic advantage in barter terms proceeding from exchange control is not strong, the case for an increase of "total gain" from this source is impossible to establish. The years in which Germany's share of world exports was high, 1930–1932, were also years of highest terms of trade and presumably also of "total gain." But high terms of trade, induced not by any discernible increase in foreign preference for German products but by the enforcement, for the time being, of the excessive official rate on the Reichsmark, would serve to reduce and not to increase the German export position. The large export surplus of these years is explained by the flight of capital, and the increase of "total gain" was transferred to foreigners! For the years after the stoppage of capital exports, both the nominal advantage in terms and the relative export position sagged off. In view of the necessary offsets which have to be made to the apparent gain in terms, the probabilities seem to indicate that exchange control produced a net reduction in the economic "total gain" of Germany's foreign trade. Many of Germany's important exports, it may be observed in passing, must have enjoyed the advantage of inelastic demand over rather wide contiguous regions.

It remains to review the record of exchange control regarding the foreign indebtedness of Germany. From mid-1931 to early in 1938, indebtedness was reduced from 24 billion to 10 billion Reichs-

1 Cf pp 242–257 above

2 According to hearsay, 36,000 civil servants devoted their time to this activity

3 Cf pp 257–270 above

marks. Of this sum, eight billions represented repurchases and redemptions, and six billions the depreciation of foreign debts through foreign devaluations.¹ To arrive at the amount of effective transfer it is necessary to subtract from eight billion Reichsmarks the depreciation of blocked accounts below a level corresponding to foreign devaluations due to the restricted applicability of these accounts, and a further sum for the repatriation of German bonds at bargain prices. A rough estimate might be in the neighborhood of one-half to one billion Reichsmarks. Thus windfalls reduced the German foreign indebtedness approximately as much as repayments. The "windfalls" are a consequence of German exchange control, for the fiction of Reichsmark parity produced the gains of foreign devaluations, and the embargo on capital exports secured the profits on bond repatriations and export against blocked marks. It should be noted that the latter two sources have yielded real profits, since they are actually already realized, whereas the first source, pertaining to debts in foreign currencies, has yielded paper profits only, which would disappear with the devaluation of the Mark. With this one reservation there is no doubt that exchange control gave to Germany substantial economic gains on its foreign debts, indeed, Piatier lists the windfalls (from the three sources named) as three out of four items in his list of advantages derived from the control by Germany.² The gain is "economic" in the sense of pecuniary advantage, but it is not an economic gain in the sense of its origin. Effective transfer from 1931 to 1938 amounted to seven to seven and one-half billion Reichsmarks, whereas expenditures upon armaments to the outbreak of war have been estimated as high as 90 billion Reichsmarks.³ In view of such facts, Germany has not secured the windfalls upon her foreign obligations without an indirect cost, for, as Saint Jean declares, she has solidly established her reputation as a bad debtor.⁴

As an emergency device for coping with the panicky withdrawals and flight of capital in 1931, and as an intermediate device

¹ League of Nations, *Balances of Payments 1937* (Geneva, 1938), p. 110. The League estimate of the effect of devaluations pertains to the period mid-1930 to early in 1937, but devaluations from mid 1930 to mid 1931 and from early 1937 to early 1938 could make no significant difference.

² Piatier, *op. cit.*, p. 138.

³ Sternberg, *op. cit.*, p. 717.

⁴ Maurice de Saint Jean, *La Politique économique et financière du Troisième Reich* (Paris, 1936), p. 438.

for controlling the balance of payments during attempts to adjust prices to international equilibrium (devaluation being in practice impossible), exchange control answered to economic ends. Since 1933 or thereabouts the German exchange control is impossible to justify on economic grounds — the monetary situation, international trade and foreign debts. It is important to establish these facts, for the German exchange control has not lacked its apologists upon economic grounds. I am inclined to believe that the political and economic powers of the National Socialist state would regard the nice calculation of economic pro's and con's with ironical amusement, knowing full well their complete irrelevancy. Even if the case were conclusive to these authorities that exchange control entailed net economic losses, it would have been retained. The losses would in all events be rendered less obvious by certain windfalls: the effect of foreign devaluations and the German capital-export embargo, the forcing of loans through accumulating clearing debts,¹ the achievement of high export prices in clearings through political pressure, the restraint upon real wages through control of "non-essential" imports, and the favorable terms of trade through the relatively high prices of industrial exports. The institution persisted because it was an instrument *par excellence* of political power — political power not only over other states but equally significantly over vested economic interests within the country. The National Socialist state developed this totalitarian instrument to one of its most formidable weapons. Unfortunately it must also be recorded that, in creating an authority against the decisions of which the law afforded no redress, the political predecessors of Hitler nurtured an institution which paved the way for totalitarianism.

1 In 1935 the German clearings debts amounted to 500,000,000 Reichsmarks and in 1938 to 250,000,000 Reichsmarks. Cf. League of Nations, loc. cit., p. 111.

CHAPTER V

THE PAST AND FUTURE OF EXCHANGE CONTROL

THE PURPOSES OF EXCHANGE CONTROL

At the outset of this study, five types of exchange control were distinguished according to the degree of their divergence from a liberal or "free" system of international payments¹. That which underlay this scheme was the contrasting organization, functioning, and economic epiphenomena of the various controls. It will be profitable, I believe, to renew acquaintance with the distinguishable types of control, but this time from the viewpoint of their purposes. Purposes also range from those which are harmonious with a liberal system to those quite incompatible with it, and there will be a rough parallel with the early classification. But the two are not identical. The original scheme, for example, distinguished (as types 3 and 4) between overvaluations of the monetary standard proceeding respectively from a flight of capital alone, and from relative inflation coupled with a flight. This difference is vital so far as concerns the economic earmarks and functioning of the two types of exchange control, but it corresponds to no necessary distinction as to the purpose for which control is maintained. From the angle of aims I distinguish seven categories²: (1) prevention of unregulated export of capital and depreciation of the currency, (2) temporary insulation to permit adjustment to international equilibrium, (3) increasing the total economic gain from foreign trade, (4) securing cheap foreign exchange for government purposes, (5) retaliation against foreign controls, quotas, tariffs, and the like, (6) protection of domestic production, (7) totalitarian economic and political control. Each of these purposes merits some elucidation³.

1 Cf pp 1-7 above.

2 In her book on World Trade (New York, 1939), p 125, Ethel B. Die trich also gives seven purposes of exchange control. Four of these (1, 2, 3, 5) fall under my first category of preventing capital export, viz., conserving the gold supply, providing means for foreign debt service, and stabilizing exchanges, and two others (4, 7) come under my caption of paternalistic or totalitarian aims, viz., securing "essential" imports and establishing a regulatory instrument of planned economy.

3 The purpose of mere stabilization against short up-and-down variations of exchange is omitted as not belonging to exchange control in the narrow sense understood in the present study, cf p 1 above.

(1) The prevention of unregulated capital export and unregulated currency depreciation is a universal purpose of exchange control, both for its introduction and for its retention. Capital export and currency depreciation are conjoined under one caption for the reason that an extensive amount of one almost inevitably ushers in the other, at least in the case of debtor countries. The League of Nations Report errs seriously, I believe, in maintaining that, beside the motive just named, "countries which resorted to this measure had *in all cases* suffered a worsening of their balance of trade, and controlled exchange with the deliberate intention of *checking imports*"¹. After the depreciation of sterling on September 21, 1931, numbers of countries introduced exchange control because of an adverse turn in their balances of trade in competition with the devalued sterling *bloc*, it is true. After certain countries had introduced exchange control, it is also true that others were forced to a similar step by the impossibility of securing devisen payments for exports. But it is clear that neither the one nor the other circumstance was universal. Indeed, in direct opposition to the League Report, the first introductions of exchange control occurred in conjunction with a strongly *favorable* turn in the balance of trade, and this was frequently the case with later introductions. Austria, typically an import economy, showed smaller import balances in 1930 and 1931 than in 1929; Hungary's trade balance changed from unfavorable in 1929 to favorable in 1930 and 1931; Germany's export balance skyrocketed from 36 to 2,872 million Reichsmarks between 1929 and 1931.² Did it escape the authors of the Report that a flight of capital produces a favorable turn in a country's balance of trade? The throttling of imports was certainly not the concern of Austria, Hungary, and Germany when they introduced exchange control. It should have been stressed in this connection, furthermore, that exchange control is notoriously effective, through its artificially high rate of exchange, in producing *unfavorable* balances of trade.

Even in those cases in which the prime mover was a loss of central bank reserves through an import surplus, the threat of currency depreciation produced also the threat of capital flight. Thus Czechoslovakia, hedged against foreign withdrawals by an

1 League of Nations, Report on Exchange Control (Geneva, 1938), p 26, *italics mine*

2 Cf pp 61, 85, 95 above, and pp 369, 380 below

equal amount of investments abroad on her own account, could nevertheless experience the danger of currency depreciation through a flight instituted by her own citizens as central bank reserves ebbed away. The same situation obtained with countries for which the freezing of export proceeds by foreign controls caused a steady shrinkage of gold and devisen stocks, whether trade balances were active or passive. It is not surprising that, in accord with the findings of the present inquiry,¹ the flight of capital is reported as the ubiquitous cause of the introduction of exchange control.² In passing it is worthy of note that the various devices for carrying through a capital flight which attracted much attention after the early summer crisis of 1931 had been actively employed in Germany for a year or more previously.³

Moratorium, devaluation, and deflation did not present eligible alternative courses of action to meet the capital flight of 1931 in the cases of Germany, Austria, and Hungary⁴, and this conclusion can probably be extended to other countries.⁵ Moratorium would have prevented foreign withdrawals but not the export of capital by nationals, it is an extreme measure which might have increased the panic psychology, whereas exchange control, though less candid, preserved the appearance of something transitory, and finally moratorium at the very onset of difficulties would have outraged the creditor interests even more than it did upon its eventual and almost inevitable appearance. Devaluation, as we have seen, was precluded by the popular identification of this measure with inflation, and the argument that it would have increased the burden of foreign debts appears to be quite secondary on short-run considerations. In Austria the opposition of the socialists to devaluation,

1 Cf pp 27-37, 76-80, 166, 171 above

2 Bank for International Settlements, "Note on Certain Aspects of the Liquidity Crisis, 1931-1932," mimeographed (Basel, April, 1932), p 10, Alexander Yovanovitch, Mémoire sur le contrôle des changes en Yougoslavie, mimeographed, Institut International de la Cooperation Intellectuelle (Paris, 1939), p 23, Jerzy Nowak, Le contrôle des changes en Pologne, Comité Central des Institutions Polonaises des Sciences Politiques (Warsaw, 1938), p 7, Virgile Madgearu, Le contrôle des changes en Roumanie, Institut des Recherches Sociales de Roumanie (Bucharest, 1939), p 7, J B Condliffe, The Reconstruction of World Trade (New York, 1940), Ch VII.

3 Melchior Palyi, "Gibt es eine Kapitalflucht aus Deutschland?" Berchner Börsen-Courier, December 9, 1930, p 7

4 Cf pp 7-13, 33-36, 88, 89, 172-173, 189 above

5 A Basch, "Probleme der Devisenkontrolle," Mitteilungen des Verbandes österreichischer Banken und Bankiers, Vol 14, No 9-10, p 224

resting on the popular confusion of the idea with inflation, was politically conclusive, and in Germany the threat of the trades unions to enforce a wage scale based on foreign currencies turned the scales, for the measure would have annihilated most of the cost-reducing effect of exchange depreciation. So far as concerns deflation, its workings would have been too slow to be effective in a crisis, and furthermore, it would have entailed social costs of increased unemployment and further contraction and liquidation. Here again the opposition of organized labor was important, though the voice of the civil servants who would have been affected by budget reductions was also heard.

The fact that after 1931 western European countries labored under a state of "perpetual crisis"—not only in political and economic matters generally, but specifically also in the sphere of short-term capital movements—served partly as a reason and partly as a pretext for protracting exchange control. As time went on, other motives for the prevention of capital export assumed an importance frequently exceeding the original purpose of maintaining the parity of currencies. *De facto* and *sub rosa* devaluation transformed the official rate of exchange to a mere face-saving fiction. What exchange control actually meant in the long run for foreign debts differed significantly from one country to another, as we shall see in a subsequent section.

(2) After the most acute stage of capital flight, exchange control

"can indeed be justified as a transitional device for the purpose of accomplishing the reduction of the gold value of the monetary standard which is inevitable for its protection—or of carrying out the necessary deflation through lowering prices and incomes."¹

The year following the introduction of exchange control in Germany witnessed the fairly consistent prosecution of this policy under Bruning, save for the failure of the government to reduce retail prices and raise interest rates.² Even from the angle of a general "reflationist" policy for combatting depression, it would not be clear that this policy was mistaken, for, as Poole maintains

"the rigorous deflationary measures of 1931 were designed in part to make possible the subsequent expansive program, through the medium of first

¹ Gottfried Haberler, *Liberale und planwirtschaftliche Handelspolitik* (Berlin, 1934), pp. 104–105.

² Cf. pp. 175–177 above.

strengthening the foreign trade position in order that measures which would later weaken it might be pursued with impunity."¹

The ministries of von Papen and von Schleicher during the balance of 1932 and early 1933 saw a gradual weakening of the deflation policy, and with Hitler it was abandoned.

Austria affords the unique example of exchange control which led finally to international equilibrium.² Because of the downward course of world prices until 1933, Austria was able to prosecute a policy of cautious and piecemeal devaluation without experiencing a rise of domestic prices. The allocation of devisen for imports had largely disappeared by October, 1932, and transactions on current account in international trade progressed over the supervised but essentially free "private clearing" market. In March and April, 1933, devaluation was legally recognized for the interpretation of long-term contracts, and a year later the National Bank revalued its gold and devisen reserves in accord with a devaluation of the Schilling to 78.2 per cent of its former parity. Exchange control persisted only in unavoidable clearings and in the embargo on capital export.

Hungary represents something of a midway position between Germany and Austria. Without definitely forsaking international equilibrium for an "autonomous economic policy," Hungary made slow progress toward the liberation of international payments, but did not consummate the process before the economic setback of 1938 and the ominous rumblings of approaching war. Prices in Hungary, as in Austria, did not decline appreciably in 1931, despite the sudden drop in effective gold prices on world markets, but from January, 1932, to September, 1933, there was a gradual decline. If exchange control had been regarded as a temporary device to secure the opportunity for international adjustment, Hungary could have devalued in 1934 or have restrained domestic prices in the teeth of rising agricultural prices on world markets to secure relative deflation. Neither alternative was taken, and despite the simplification of exchange control, the refunding of foreign debts, and the resumption of devisen payments on the debt service, the growth of autarkic sentiment prevented the final steps in the process.

1 Kenyon E. Poole, *German Financial Policies, 1932-1939* (Cambridge, Mass., 1939), p. 25.

2 Cf. Chapter II above.

The histories of Germany after 1932 and Hungary after 1933 illustrate the point made by the League of Nations' Report, that exchange control can serve as a cover not only for the gradual process of achieving international equilibrium but also for a "policy of internal credit expansion which raises internal prices much above the world level"¹ Furthermore, unless the overvaluation of the currency is offset by other devices, exchange control actually works against the debtor nation through stimulating imports and thus postponing the day of equilibrium in the balance of payments. The maintenance of exchange control in Germany and her satellite countries delivered a body blow to economic cooperation and "peaceful change." In part extenuation of this course it deserves to be remarked for the reflection of the light-hearted advocates of free exchange rates that, as Professor Fanno concludes, the depreciation of currency in "a country which is an important economic center and is in addition a center for the financing of world trade" enforces depreciation elsewhere, and paralyzes the foreign trade and economic life of the world.²

(3) Exchange control has also been directed toward increasing the gain from international trade. This subject is reserved for fuller treatment in a later section, but it is clear that the theoretical possibility exists, in case the country enjoys a monopoly or monopsony in significant lines of export and import respectively, for changing not only the terms of trade but also the "total gain" in a favorable direction (terms multiplied by volume). The mere fact of transportation costs affords a certain monopoly or monopsony zone, and this margin may be increased by other obstacles to trade such as tariffs, quotas, and import and export prohibitions. "On paper" there would seem to be opportunity to exploit this margin, either by the enforcement of a unique rate of exchange above the competitive equilibrium level or by discriminatory rates. Throughout its pre-war exchange-control history Germany operated upon the basis of monopolistic discrimination, and Hungary followed suit until late in 1935, but in Austria the practice did not go beyond the narrow sphere of exporting against *Sperrschillings* at different discounts for a short interval. We shall recur to the experiences of Hungary and Germany, which were not crowned with success from

1 League of Nations, Report on Exchange Control, p 28

2 Marco Fanno, Normal and Abnormal International Capital Transfers (Minneapolis, Minn., 1939), p 98

an economic angle Recently it has been urged that England raise the pound rate and even discriminate in the straits of war between various categories of exports to increase the gain of trade¹ From the viewpoints of probable success and of adverse repercussions upon international trade, artificially high and discriminatory rates of exchange would seem to be more defensible in war than in a peace economy²

(4) The Treasury is always able in an exchange-control country to procure foreign devisen at the low official rate for its own purposes Undoubtedly the fiscal purpose of exchange control rarely supplies its chief justification In Rumania, indeed, it is asserted that "the demand of the government for devisen nearly always exceeded that of private persons"³ But in any event the securing of a continuing supply of foreign exchange at bargain prices might explain the continuance of exchange control and a wholly fictitious official rate in situations where they had otherwise lost their *raisons d'être*

(5) Once exchange control had been established by the important trading partners of a given country, the introduction of control for its own economy might be conceived as a "retaliatory measure" in a broad sense "Retaliation" usually connotes the idea, however, of attempting to induce the cessation of the offensive action, and this could scarcely be imputed to all exchange control systems introduced after, say, October, 1931 In this narrower sense examples are not altogether lacking of retaliatory exchange-control systems, and *pro tanto* of exchange-control measures Austria made extensive *de facto* departures but retained the entire legal structure of control, in order at any time to impose a retaliatory freezing of accounts in response to a similar foreign course England threatened a compulsory clearing and the levying of a 20 per cent import tax upon German goods as a means of protesting against the Moratorium of July, 1934⁴ On May 6, 1935, Germany promulgated a *devisenpolitisches Abfertigungsverbot*

1 Grenville Holden, "Rationing and Exchange Control in British War Finance," Quarterly Journal of Economics, Vol 54, No 2 (February, 1940), pp 171-201, Thomas Balogh, "Foreign Exchange and Export Trade Policy," Economic Journal, Vol 50, No 197 (March, 1940), pp 1-27 Balogh, but not Holden, recommends discriminatory rates

2 Cf pp 314, 341-343 below

3 Madgearu, op cit., p 37, cf also pp 8-9, 21

4 Cf p 201 above

against France and Czechoslovakia, requiring special import certificates for the goods as an answer to alleged discriminations against Germany¹

(6) Sooner or later virtually every exchange-control system has lost its original orientation toward the monetary standard and capital flight and has become an instrument for ulterior ends. Since exchange control ordinarily involves an overvalued currency unit, imports — though unusually profitable at the official exchange rate — stand to be reduced in quantity relatively to exports. Domestic lines of production which have to compete with imports are thus protected. In predominantly industrial countries, such as Austria and Germany, agriculture benefited, and in a predominantly agricultural country, such as Hungary, the relative gain accrued to industry. Protection in the old-fashioned sense appeared as a by-product of attempting to defend the currency, but it proved to be so welcome a by-product as certainly to become an end itself.

Yet protection in the traditional connotation of measures to increase the domestic market for home industries in a competitive regime falls sadly short of the "ulterior aims" of exchange control in its later phases. The nearest of kin, which is nonetheless an extension of the older concept of protection, is the effort to reach "full employment." Whether the unemployment is regarded as a cyclical or secular matter is a matter of indifference, for it is generally agreed that the German program of expansion had no discernible reference to cycle theory.² Though ulterior to monetary and financial aims, the purpose of reaching full employment would certainly be considered, on its face value at least, as an economic end. Guillebaud's book, both by the evidence of its title, "The Economic Recovery of Germany," and by its tenor throughout, regards the developments — rather naively in my judgment — from this angle. Through the years 1931 and 1932 the German governments were indeed primarily concerned with the relief and combatting of unemployment, though exchange control was not one of the weapons. From 1933 onward unemployment decreased and finally in 1938 and 1939 gave place to a labor shortage, and exchange control as a protectionist device undoubtedly aided the process. It is undoubtedly true, as A. G. B. Fisher declares, that

1 Cf pp. 222 above.

2 Cf Poole, *op. cit.*, p. 75, and C. W. Guillebaud, *The Economic Recovery of Germany, 1933–1938* (London, 1939).

"the Germans believe that the same measures which insure their economic independence and make them impregnable in a military sense will also insure immunity against the virus of the trade-cycle¹ But which was the fundamental aim?

(7) Had the fundamental aim of totalitarian states actually been the furtherance of home industry, exchange control would have been abolished at the behest of the export interest, for it clearly preponderates in the German economy. Had the fundamental aim actually been the extension of employment, on the other hand, it would scarcely be conceivable that the standard of living should be treated in so stepmotherly a fashion. Furthermore, in order to promote home employment, exchange control would not have been permitted to decrease exports relatively to imports and hold them at this low level. It has been observed by more than one writer² that exchange control differs from Mercantilism in that exchange control sometimes seeks to expand exports with the avowed aim of increasing imports. But such an aim does not conform to a Keynesian program of increasing domestic employment through protection. Nor does the ideal of *autarchy* — the creation of an *international* self-sufficient unit dominated by the needs and aids of the totalitarian nation — conform to this program, as would *autarky, tout simple*.³

The aim of exchange control in Germany after the advent of the National Socialists was the furtherance of their economic and political power both abroad and at home. On the side of foreign trade and international relations, as a German writer has said, "regionalism, *Grossraumwirtschaft*, preference systems, imperialistic policy — these are the catchwords which must be named in this connection,"⁴ or as a French writer has more pointedly expressed the purpose, *une économie de guerre*.⁵ So much has been recognized. But there is some danger of neglecting the significance of exchange control in the domestic economy. Exchange control is indeed an effective device for regulating all items in the balance of

1 A G B Fisher, *Economic Self Sufficiency* (Oxford, 1939), p. 22.

2 H R Hormi, *Memorandum on the Exchange Clearing and Compensation System as Applied by Finland*, and André Piatier, *Exchange Control A General Survey*, both works presently to be published by the International Institute of Intellectual Cooperation, Paris.

3 Cf. p. 190 above.

4 Hans Brockmann, "Devisenloser" *Zahlungsverkehr* (Hamburg, 1935), p. 127.

5 Piatier, *Le contrôle des devises*, p. 138.

payments, as Heuser concludes¹, it is furthermore, in Balogh's words, "the fulcrum of the central control of all important primary commodities"², but it is finally a device by which a dictatorship achieves and continues to exercise control over the economic and political destinies of the populace

FOREIGN DEBTS UNDER EXCHANGE CONTROL

Inasmuch as an original and continuing purpose of all exchange control has been the prevention of unregulated capital exports, it is significant in an appraisal of the institution to review its record concerning foreign debts. A comparison of the accomplishments of Germany, Hungary, and Austria will reflect, beside the general course of developments, the relative importance of certain other purposes of exchange control as set forth in the preceding section. The investigator encounters difficulties because of the different dates at which estimates of foreign indebtedness have been made for the several countries, but these discrepancies can be allowed for in interpreting the data. Estimates are lacking for Austria in 1931, and the comparison cannot extend beyond 1937 because of the absence of statistics for Hungary and because of Austria's disappearance as a separate state. Despite these limitations, certain contrasts are evident.

Compare first Germany with Austria: the former reduced her debts by 57.9 per cent and the latter by 55.7 per cent in the intervals given in the table on p. 169. But the interval is a year and a half longer for Germany than for Austria. During this interval sterling devaluation occurred; the windfall augments the German but not the Austrian total debt-reduction percentage as given in the table. But only 25.8 per cent of Austria's debt reduction was caused by foreign devaluations, whereas 43.5 per cent of Germany's came from this source. Germany's actual payments were therefore substantially lower than Austria's as a percentage of debts outstanding in mid-1931.

This record is the more striking in view of Germany's advantage in terms of trade by virtue of her more highly fabricated exports, in view of Austria's faltering *Lebensfahigkeit* in the eco-

¹ Heinrich Heuser, *Control of International Trade* (London, 1939), p. 205.

² Thomas Balogh, "The National Economy of Germany," *Economic Journal*, Vol. 48, p. 481.

	REDUCTION OF FOREIGN DEBTS UNDER EXCHANGE CONTROL*		
	Austria Million Schillings	Hungary Million Pengo	Germany Million Marks
1 Foreign debt	4,251 year-end 1932 1,881 year-end 1937 <u>2,370</u>	4,310 year-end 1931 2,500 July 1937 <u>1,810</u>	23,800 July 1931 10,000 February 1938 <u>13,800</u>
2 Amount reduced			
3 Percentage reduced	55.7%	41.9%	57.9%
4 Amount of reduction due to foreign devaluations	610	1,376	6,000
5 4 as percentage of 2		76.0%	43.5%
6 Amount of reduction due to reparations		350 to July 1937	781 to November 1933
7 6 as percentage of 2		19.3%	5.6%
8 4 and 6 as percentage of 2		95.3%	49.1%

* For data and sources of pp 54-55 142 144, 146 231, 287 above

nomic sphere, and in view of the achievement of full employment in Germany Ohlin has pointed out that full service on German foreign debts would not have exceeded five dollars *per capita per annum*, and that this amounted to no more than one-fifth of the figure for New Zealand and Australia and one-third the figure for Argentina.¹ A further comparison, which does not appear from the figures in the table, may be drawn. In 1933 Austria and Germany stood upon approximately equal footing as to *per capita* foreign debt (476 and 487 Schillings) and also as to ratio of total foreign debt to total exports and imports (163 and 159 per cent)², and yet by April 22, 1933, Austria had converted her blocked accounts to free accounts, and by December 10, 1934, had completely liquidated the Standstill debt, whereas Germany even in September, 1938, was accumulating new categories of blocked accounts and had not completed the payment of the Standstill debts.

The debtor countries undoubtedly encountered severe difficulties not of their own making — the handicap to their exports through foreign devaluations, protective tariffs and quotas, and the willingness of creditor countries to sacrifice the volume of current trade to amortization quotas.³ But it remains to be shown that Germany suffered more in these respects than Austria. One might be disposed to conclude that the transfer capacity of a country which largely abandoned exchange control exceeds that of a country which maintains it. The deduction would probably not go far amiss, and yet the question remains why one nation relegates the control to relative desuetude whereas the other takes it as the key-stone of the economic system. Is it irrelevant that the Munich program of the National Socialist party proclaimed the liberation of the State from all debts contracted with the "capitalistic countries"?⁴ The ground for this policy was the conviction, which Schacht dinned in the ears of the world, that Germany's debts represented only a refunding of the Versailles "tribute."

¹ Bertil G. Ohlin "International Economic Reconstruction," in the volume bearing the same title published by the International Chamber of Commerce (Paris, 1936), p. 89.

² Gustav Warmer, "Die Auslandsverschuldung Österreichs," Mitteilungen des Verbandes österreichischer Banken und Bankiers, Vol. 16, No. 10-11, pp. 290-291.

³ H. J. Tasca, World Trading Systems (Paris, 1939), pp. 83, 95, 122, *et passim*. The author dwells upon England's attitude as an example of the last obstacle named above.

⁴ Cf. Saint Jean, *op. cit.*, p. 436.

The reduction of Hungarian foreign debt by 41·9 per cent, between one-fourth and one-fifth less than the figures for Austria and Germany, is probably adequately accounted for by the severity of agricultural depression and adverse developments in the Hungarian terms of trade¹ So small were the actual repayments on Hungarian debts, however, that foreign devaluation accounts for 76 per cent of the total reduction, the repatriation of bonds (which does not represent repayment to persons desiring it) 19·6 per cent — together 95·3 per cent, whereas the German percentages are 43·5, 5·6, and 49·1 respectively² The German figure for repatriations does not extend past November, 1933, but the process had nearly run its course by that time, and the relative share of debt reduction from this source (5·6 per cent) would not be substantially less than the ultimate figure In view of her general economic situation it is not surprising to discover that Hungary repaid so small an amount of her foreign debts It is little less than a scandal, however, that the differential between the foreign and domestic prices of Hungarian bonds should have been exploited by the State instead of accruing to private individuals within the country as a pure windfall Had the exchange-control authorities not fallen victim to vested interests or inertia, the repatriations would have operated to improve instead of decreasing the Hungarian volume of trade³ The most obvious result of a comparison of Germany and Hungary on the matter of foreign debt liquidation is the conclusion that if exchange control is to be, it must be thoroughgoing The administration of the control forms the topic of the next section, but certain observations are still in point on the present subject

Exchange control is beyond doubt justified in its prevention of capital exports at a more rapid rate than the financial and economic structure of the debtor country permits or the disposition or economic capacity of the creditor country to receive payment in goods allows Against a sudden panicky rush of foreigners and nationals to transfer funds, as in the summer of 1931, it is necessary, as in the case of commercial banks, to defend central banks For the longer period, after the quelling of the original revolt but during a continued restiveness on the part of foreign creditors and

1 Cf p 131

2 Complete figures for repatriations in Austria have not appeared

3 Cf pp 145-147

domestic capitalists, it has sometimes been said that a depreciation of the currency would provide the necessary brake to withdrawals I do not subscribe to this belief Since foreign debts for most central European countries were incurred in foreign currencies, the depreciation of the debtor currency did not operate, depreciation may moreover add fire to the flame of capital withdrawals or flight, finally, even if a sufficient export surplus could be developed, the movements of flight capital, having no particular economic justification, would produce dislocations in world trade which subsequently would have to be undone¹

For reasons of this sort, the systems of blocked accounts² in the various exchange-control countries, together with the transfer-accounts managed by the monetary authorities³—the Foreign Creditors' Fund in Austria, the Cash Office of Foreign Credits in Hungary, and the Golddiskontbank fund in Germany—had an economic rationale comparable to the fund managed by the Agent General for Reparation under the Dawes Plan The device of liquidating these balances through “additional” exports had also a legitimate foundation Furthermore, that these *Sperr* accounts should sell at a discount even below one which would reflect the real equilibrium value of the exchange-control country's currency has a certain justification in the lagging recognition on the side of creditors of the drastic fall in interest rates during depression Interest reductions did indeed figure in the renewals of the Stand-stills⁴, but it is fair to assume that the fall of contractual interest did not keep abreast of market rates in the intervals between revisions

This apology for the general treatment of debts under exchange control does not extend to its actual administration in all respects The Agent General for Reparations may indeed have erred favor-

1 Cf Bank for International Settlements, loc cit, pp 34–35, Herbert Gross, “Ausgangspunkte, Formen, und Wirkungen der Devisenbewirtschaftung,” Archiv für Sozialwissenschaften, Vol 69, p 54, Paul Einzig, Exchange Control (London, 1934), p 108

2 Cf pp 18, 50–51, 81, 132–141, 145–146, 178, 198–200, 236–241 above

3 Cf pp 53–54, 97, 141–146, 178, 198–200 above and p 372 below

4 Cf League of Nations, Quarterly Reports on the Financial Position of Austria (Geneva, 1932–1936), *passim*, and Quarterly Reports on the Financial Position of Hungary (Geneva, 1932–1938), *passim*, and pp 178, 198, 213, 214 above

ably to creditors' interests, but he was clearly instructed to observe the debtors' interests and the effect of transfers upon the German domestic economy. The administration of the blocked accounts and Foreign Creditors' Funds was based upon no agreement with creditors,¹ and it cannot be exculpated from the charge of arbitrariness and even exploitation in suddenly changing and frequently narrowing the permissible uses of frozen accounts. It must furthermore be recorded that the concept of "additional exports" departed farther and farther from its origin in the utilization of blocked accounts and even the repatriation of securities, it came eventually, as we have seen,² to be indistinguishable from exports in general, for which, under the overvalued official exchange parity, *ad hoc* devaluation or subsidies had to be provided.

In concluding the analysis of foreign debts under exchange control let us advert to a theoretical question pertaining to treasury borrowings from the foreign creditors' funds. Objections were raised to this practice by certain economists³ on the grounds that it undid the very deflationary pressure which it was the purpose of the fund to cause in order that exports be stimulated and the real transfer be brought to pass. While this reasoning is partly correct, it misses the fact that the purpose of the fund was not merely to transmit private debt liquidation automatically into effective transfer, otherwise there would have been no purpose in Standstills, Moratoria, and capital-export embargoes. The purpose of the fund was rather to serve as a buffer between private and national repayments, to employ terms proposed by Varga.⁴ The Dawes Report, according to Varga's argument, missed the real point in distinguishing the national "raising" and the national transfer of funds for repaying debts—the real contrast should run between private "raising" (repayment, as into a fund) and national repayment. If a nation "raises" the money, it has sequestered a certain amount of purchasing power, and if so the transfer is ordinarily effected by the attendant price-level reduction. Varga's argument

1 The administration of these funds should not be confused with such matters as the Standstill agreements themselves, the Credit Anstalt liquidation, etc.

2 Cf pp 84–85, 133–144, 199, 200 above

3 Cf p 132

4 Stefan Varga, "Bemerkungen zu den Problemen von Aufbringung und Transfer," Economic Essays in Honour of Gustav Cassel (London, 1933), pp 649–663

is correct, I believe. The discharge of debt by an individual's payment into a State fund has no direct significance for transfer. And the fund itself has no significance for transfer in and of itself, but only as it forms a part of the general monetary situation. The amount of transfer will not exceed the accumulation in the special fund, if this exhausts the sums which can legally be remitted abroad. How far the actual transfer falls short of this limit depends solely upon the willingness or ability of the monetary authority to create a price-level differential between the home country and foreign countries, either by pressing deflation faster or restraining inflation. State borrowing from the fund represented a deliberate choice of limiting transfer, whatever private repayments might be. So too did the provisions for domestic utilization of *Sperrmarks*, including, as Brockmann observes, the *Effektenspermark*, which could be used for the purchase of domestic securities.¹ In other words, if the State interposes exchange control and a foreign creditors' fund between debtor and creditor, transfers depend upon fiscal policy and no longer upon an impersonal mechanism.

ADMINISTRATIVE EXPERIENCE

The interest of the economist in exchange control does not center in its administration or in the mass of legal provisions and decisions under which it operates. A few essentials are, of course, indispensable to an understanding of the institution, but even to know what are essentials is difficult, because of the diverse aims of various national systems. The most widespread sort of exchange control is the fifth type identified in the introductory chapter, involving three main characteristics: (1) the maintenance of a (more or less) overvalued rate (or rates) of exchange, (2) the prohibition of capital export except under supervision, and (3) government regulation of imports. One does not speak wholly facetiously in saying that to enforce these principles the government must "prohibit everything." More specifically, "full" exchange control entails the following state monopoly of devisen and precious metals, including the compulsory sale of existing stocks in private hands, fixing of official rates of exchange and prohibition of publication of non-official rates, the prohibition of exports of devisen, money, precious metals, and foreign securities, the requirement of

¹ Brockmann, *op cit*, p 91

guarantees that devisen proceeds will be forthcoming for exports of goods, the prohibition of capital exports in the form of loans to foreigners, the prohibition of depositing devisen to domestic accounts, of depositing domestic money to foreigners' accounts, of transferring funds between foreigners' accounts, or between foreigners' and residents' accounts, or *vice versa*, prohibition of imports of domestic money, of foreign securities — and of foreign goods without the permission of the import authority, registration and frequently the compulsory sale of foreign securities, the prohibition of export and import transactions with certain countries except through the clearing, and of barter dealings except under government auspices¹

The animus of certain of these prohibitions is not always self-evident, hence they were lacking in the exchange control structures of some countries, with consequent evasions. Thus the existence of a free market in gold might seem innocuous, if the export of gold were effectively suppressed. The objections are, first, that the price of gold affords too painfully conspicuous and faithful an indicator of monetary depreciation, whereas exchange control is partly explicable as a Machiavellian device for veiling this fact from the populace, and second, that free dealings in gold make it easier for professional smugglers² to operate. The free gold market maintained by the Vienna mint operated throughout the Austrian experience, and it was not until March, 1935, that the market in Budapest was suppressed.³ The lesson that transfers between foreigners' accounts permit evasion is apparently not easily learned. Here again, if it were easy to prevent the transfer of

1 A number of countries maintain official or quasi-official digests of exchange control law and practice, such as Wilhelm Keding, *Devisenarchiv* (Berlin, March, 1936 to date), for Germany, K M Wehr and J Kozák, *Kommentar zu den Cechoslovakischen Devisenvorschriften*, together with periodical Supplements, for Czechoslovakia until its disappearance as a separate state, for Hungary, *Vereinigung der Sparkassen und Banken*, Budapest, *Devisenbewirtschaftung in Ungarn*. Cf also *Bank for International Settlements, Foreign Exchange Regulations in the Different Countries* (Basle, 1931-1938), Bureau of Foreign and Domestic Commerce, *Foreign Financial News* (Washington)

For an excellent summary of legal problems in this connection, cf Arthur Nussbaum, *Money in the Law* (Chicago, 1939), Ch VIII, Debts under Exchange Control

2 In the topsy-turvy world of exchange control, where debts are an economic fulcrum and where "devisen citizenship" is not a matter of birth, a smuggler conveys contraband *out of the country*

3 Cf pp 64-65, 147 above

funds or actual money from a foreigner's account to the account of possession of a resident, no harm could be done. Since the latter operation permits profitable export without devisen receipts and represents a flight of capital, and since transfer between foreigners facilitates transfers to residents, both must be prohibited. Austria permitted both kinds of transfer during the first few months of control, and even the reintroduction of full control under German sovereignty was attended with the same shortcoming.¹ The exchange control of Great Britain in the present war has also been criticized on this score.² A third illustration of superficially unnecessary measures is found in the prohibition of the reimportation of domestic money. In Hungary this was never prohibited, in Austria the President of the National Bank said that the measure would serve only to drive down the foreign value of the currency³, and in Germany the practice was prohibited only on December 6, 1935. President Kienbock's observation is correct, and if it were possible to prevent the export of money completely, it would actually be better to refrain from a prohibition of import. But if a considerable supply leaks out, the motive to exportation may be undermined by a sufficiently drastic limitation on importation to destroy the foreign price.

Ferreting out evasion absorbed a large share of the time of the exchange administration in every control country. Beyond peradventure it was not only the liberal disposition of the central bank management in Austria but also the notorious evasion of exchange-control regulations,⁴ especially through the purchase of foreign securities, which accounted for the short duration of the experience. Hungarian control was also incomplete, in this case most notably through the incapacity of the authorities to prevent the private repatriation of securities.⁵ By the testimony of all observers, Germany maintained the most effective control, although not without numerous revisions to cope with evasion.⁶ As late as December 15, 1936, it was thought worthwhile, in a decree imposing the death

1 Cf pp 40-43, 70 above

2 Cf Balogh, Economic Journal, Vol 50 (March, 1940), p 4

3 Viktor Kienbock, "Die Durchführung der Devisenbeschränkungen und Ihr Einfluss auf die allgemeine Wirtschaftsbedingungen," address to the Bank for International Settlements, mimeographed (Basle, May, 1932), p 10

4 Cf pp 40-44, 65 above

5 Cf pp 81, 142-148 above

6 Cf pp 167, 175, 181-182, 204, 220 above

penalty for "economic treason" (chiefly violations of the exchange-control laws) to provide an amnesty — the last of a series since 1931 — for those persons who revealed their hidden supplies of foreign devisen before January 31, 1937. Economists of liberal persuasion can derive no comfort, however, in the reflection that the system breaks down through evasions. Devices for evasion are indeed myriad, but the ubiquitous secret police of totalitarian regimes and extreme severity of punishment can be counted upon to extirpate all but a negligible amount of violation, except that condoned or practiced by the State itself.¹

Administration of exchange control has resulted in sophistication upon other matters than evasion. For one thing it has become apparent that the allocation of devisen necessitated by the high official rate on the home currency cannot ultimately be other than arbitrary. Germany does indeed afford an almost unique illustration of allocation according to an "objective" scheme from August, 1931, to the summer of 1934. But the basing of allocations upon foreign exchange requirements by firms during a previous period, even if rigorously adhered to, necessitates departures to permit the entry of new firms in place of those withdrawing from the market. Who shall be the new firm, and what objective justification is there for maintaining the continuing firms upon precisely their old standing relatively to one another? Inevitably this rule of thumb is abandoned for a more "reasonable" basis. A German apologist for exchange control declares that it secures stability in the monetary standard "through preserving the equilibrium of supply and demand."² If the equilibrium is not produced by the movement of price, it is achieved only by rationing on the basis of the most "necessary" imports. But what imports are more necessary, what basis of rationing is most reasonable? For what necessary, and to whom reasonable?

Another result of administrative experience is the discovery that official valuations upon currencies are very difficult to main-

1. The London Economist, Vol. 134 (February 4, 1939), p. 255 reported that large amounts of brand new Reichsbank notes were flooding the London market. Presumably the German authorities themselves were the source of these notes. By violating the Devisen Law in exporting the notes and again in permitting a small inflow sufficient to support the foreign quotation, the authorities were able to command a certain amount of foreign devisen from foreigners gullible enough to hold the notes for speculation.

2. Carl-Hermann Muller, *Grundriss der Devisenbewirtschaftung*, 2d ed. (Berlin, 1939), p. 327.

tain As in any sort of rationing, it is difficult — though not impossible — to prevent the joining of forces between those who would pay more rather than forego the purchase, and prospective sellers who would gladly receive a higher price Of all elements in exchange control the official rate has been the element most frequently sacrificed It is not necessary to review the gamut of devices — special frozen-currency rates, premia and surcharges, “additional export” rates, varying proportions of payment at the official and at special clearing and other devalued rates — encountered in the course of this study The Hungarian and German experiences show a constant increase of trade under these devalued *ad hoc* currency units, until from 75 to 80 per cent of the total foreign trade was included It should be noted that the successful functioning of clearing with another equally-devalued-currency country is no exception to the rule

Finally, it appears clearly from the control histories that bilateralism in trade retains its essential characteristics despite permutations of form Evidence to this effect appears not only in the ambiguity of such words as “compensation” and “payment agreement” in the technical literature, but also in the vogue enjoyed by such barter devices as Aski Marks and payment agreements,¹ and their subsequent engulfment in the general welter of clearings It is generally recognized now that their essential character is the same² The final sections of the present chapter disclose why this is true

RATES OF EXCHANGE

To the degree to which authoritarian interference in international trade and payments becomes a matter of control of the composition of imports and exports, their source, destination, and quantity, *trade control* supplants *exchange control* It is undoubtedly true that protection, autarky, and totalitarian control have gradually taken the ascendancy over the original, primarily monetary and financial aims of these interferences, and this ascendancy bids fair to persist in the future It still remains true, however, that

1 Cf pp 213–216, 218–221 above

2 For example by Margaret Gordon, Barriers to World Trade A Study of Commercial Policy (in process of publication), Ch VII, Tasca, op cit, pp 88–89, Muller, op cit, p 344, League of Nations, World Economic Survey 1935–1936 (Geneva, 1936), p 212 and Condliffe, op cit, Ch VIII, but apparently not by Dietrich, op cit, pp 139–140

official and more or less artificial rates of exchange characterize the situation, they supply the main explanation of the introduction of exchange control, and through their metamorphosis into discriminating monopoly prices on an international scale, they may become commonplace in the future. Let us briefly review the results of the present investigation so far as concerns rates of exchange measures of the overvaluation involved in official rates, departures from official parities, the relation of actual exchange rates to monetary equilibrium, and the pro's and con's of devaluation.¹

To conceive — and much less to measure — the overvaluation of a currency under exchange control as a unique phenomenon is not possible. The market for bills of exchange ceases to be a unit, not only because payments are forcibly separated into imperfectly communicating subdivisions, but also because trade itself is marked off into categories, e.g. by countries, by method of "balancing," according to whether the items are ordinary or "additional," transit or not, for current account or the liquidation of debts, for domestic consumption or for fabrication and reexport, and the like. Consequently we discover a plurality of measures of overvaluation purchasing power parity, export prices, the domestic price of gold bullion or foreign securities, quotations on domestic currency in a foreign market, quasi-official or official premia and surcharges on foreign devisen, the prices of *Sperr* accounts, and the percentage of subsidy per unit of exported goods. The eligibility of each of these measures differs considerably amongst national economies.

Purchasing power parity, deriving as it does from the relative movement of general wholesale indices from some base year representing approximate equilibrium, might be expected to afford a measure only over long periods when disturbances induced by capital movements and changes in reciprocal demand had run their course. Its usefulness is conditioned, furthermore, by the freedom of domestic prices to move under ordinary supply and demand forces. Over the two-year period from the middle of 1931 to the middle of 1933, when the Schilling reached its eventual depreciated level of 78.2 per cent, Austrian sensitive prices had moved about reciprocally to this index for the United States and Germany.²

1. The subject of multiple or discriminatory rates will be examined in the following section in connection with the "terms of trade."

2. In the present section and the two subsequent sections, references to

In the case of Hungary, we have been able to trace a rough parallel between the relationship of Hungarian to British wholesale prices, on the one hand, and other measures of pengo depreciation, on the other. The prevalence of price maxima in Germany would cause a computed index of purchasing power parity to underestimate the overvaluation of the Reichsmark, but in conjunction with other information this index shows approximately the overvaluation (50 to 75 per cent) relevant to a unitary devaluation to equilibrium in the last years before the war. Export prices cannot be employed in lieu of wholesale prices, if exports are subsidized or maintained by debtors' windfalls on frozen accounts.

The quotations on gold in Vienna throughout the Austrian experience and in Budapest to March, 1935, were subject to sharp short-term fluctuations not shared by commodity price indices, but in the long run they showed trends similar to purchasing power comparisons. For short-period movements again, the Austrian Business Cycle Research Institute made successful use of the Vienna quotations on Swiss railway bonds compared with the Zurich prices, but in Hungary and Germany the suppression of a free market in foreign securities prevented the resort to similar indicators. We have found that Zurich quotations on pengo notes, while subject to peculiar movements of their own, conformed to other indices over longer periods, but the rigor of German regulation of the traffic in notes over the border made the foreign prices on Mark notes insignificant for general comparisons.

Where a government itself modifies or tolerates deviations from the official parity in ordinary trade involving the national currency unit itself, these rates of exchange indicate how great the overvaluation has come to be at a minimum, but they seldom recognize its full extent. Austria did, indeed, arrive at an equilibrium value of the Schilling by permitting supervised dealings on the "private clearing" market, Hungary pursued a more halting course, permitting only officially established premia and surcharges, generally lagging behind actual depreciation, but Germany has never officially recognized depreciation in the Reichsmark itself. Concessions were occasionally made in clearing rates to prevent a revolt by Mark balance holders. Our investigations have shown supporting passages in the body of the monograph are not given, except occasionally, because of the great number which would be required. Relevant information can be found by consulting the index.

that the quotations on various categories of frozen accounts give no reliable measure of currency depreciation, being subject to a number of stronger variables than the behavior of domestic prices — most notably limitation on the uses of each category, changes in these prescriptions, and anticipations concerning the solvency and political future of the country. In the case of Germany, the percentage of subsidy per unit of export was found to cover most, but not all, of the margin between German and English wholesale prices, on the one hand, and German and English export prices, on the other. The remainder is explicable as the margin of overvaluation which Germany could cover by discriminatory rates of exchange in place of a uniform rate. Since the discrimination raised the "real value" of the Reichsmark somewhat,¹ the Mark overvaluation to foreign importers was still indicated by the export price comparison, the overvaluation for devaluation retaining discrimination, by a comparison of wholesale prices *minus* the German export subsidies, and the overvaluation for devaluation eliminating discrimination, by a comparison of wholesale prices.

While overvaluation has continued to characterize exchange control systems with few exceptions, the inevitable retarding of exports and acceleration of imports very shortly forced departures from the original official parities. Three of the seven potential measures of overvaluation described in the preceding paragraphs also represent methods of introducing devaluations without sacrificing the formal parity premia and surcharges on foreign devisen, exporting against frozen accounts, and subsidies on exports. The last method includes, beside the forthright granting of State funds to exporters, a number of less direct devices, such as the Polish system of low freight-rates on export merchandise, and the German system of levies through which an entire industry supported its export branch. To these methods may be added *de facto* devalued rates permitted for certain clearing relationships, and occasionally for barter or compensation, as for example with the Aski Marks. The official rate is also surrendered when the State permits exporters to retain devisen to cover their imports of raw materials, as in the Austrian and Hungarian "certificate system", or when the State requires varying proportions of exporters' devisen to be surrendered.

1. The discrimination often rested upon non-economic bases — upon practices which would generally be considered unfair competition — hence "real value" has to be considered in a purely indicative sense.

at the official price, as in the Austrian "raw material quota." Finally, there comes the special exchange rate applied to "additional exports," which may embrace all or only a portion of a given export parcel. These devices are frequently combined for one transaction, the actual export yield is then an intricate computation, and the results, as in most other cases of deviations from official parity, remain confidential between trader and exchange-control authority.

The long and short of these various indirect, half concealed and *de facto* devaluations has been a strong tendency for a "real" or equilibrium rate of exchange to reassert itself, despite the paraphernalia of exchange control. The Austrian private clearing rates moved gradually into accord with the price of gold, with quotations on foreign securities, with "home determined" prices in comparison with prices determined abroad, and with the relative movement of domestic and foreign sensitive price indices. In Hungary, a one-third depreciation of the pengo by the end of 1931, as indicated by Hungarian and British wholesale (gold) price indices and by black bourse quotations on dollar exchange, was not incorporated fully into premia surcharges on foreign free currencies until late in 1935. Meantime the pengo had undergone, first, an appreciable strengthening and, during 1934, a deterioration by the evidence of the same indices, complemented by the behavior of the Budapest gold price and the quotation on pengo notes in Zurich. At its introduction in December, 1935, the premium and surcharge system established approximately correct rates for the free relations and for clearing with Germany, though overvaluing the pengo relatively to the Schilling. The pengo appears not to have been seriously overvalued by the continuation of these rates through the years of recovery (especially of agricultural prices) to 1937, thereafter the institution of a sweeping spending program led to price developments which made the old premia and surcharges inadequate. It does not appear desirable to review the more complex situation of the German rates, except to emphasize again for the present context that, in general, effective export rates had to fall sufficiently to absorb the overvaluation not covered by subsidy and monopolistic discrimination.

Why were the largely fictitious official exchange rates not abandoned? It has been the evidence of the present study that the rationale of the old gold parities became increasingly tenuous as time went on, and that increasingly auspicious occasions presented

themselves for devaluation. Central European countries were not able to follow the example of England in September, 1931, primarily because of the popular confusion of devaluation with inflation and the danger of a velocity inflation at home through a domestic flight from the currency, because of the opposition of strong political groups, including the Socialist or labor parties, and finally, because of an (undoubtedly exaggerated) regard for the real burden of foreign debts. The *de facto* devaluation of the Schilling during 1932 and 1933 could proceed despite these obstacles, because the continued fall of world prices permitted currency depreciation without an absolute rise of domestic prices. Devaluation was not apparent to the masses of the populace, and the National Bank took care to recognize the depreciation by a series of cautious steps so as never to attract attention to the process.

In Germany, exchange control served from the late autumn of 1931 to the latter part of 1932 as a medium-term device to support the Reichsmark while a deflationary adjustment to world prices could be pressed forward. Dollar devaluation in 1933 offered an occasion for an adjustment of the Reichsmark, for Reparations had been virtually annulled in 1932, foreign debts had been substantially reduced, and the tendency of world prices was still downward. Had Germany taken the step, already virtually complete in Austria, the currencies of most Central and Southeastern European countries could also have been devalued and most of the exchange controls could have been removed. The gold *bloc* devaluations of 1936 offered another golden opportunity, for by that time the German economy was thoroughly controlled within, and the foreign debts reduced to half their magnitude in 1931. Since Germany did not move, it was difficult (though not impossible) for Hungary to institute a devaluation. The funding of the Hungarian debt and the resumption of effective *devisen* transfer in the summer of 1937 supplied another and, as it proved, a final opportunity for abolishing the fictitious gold pengo.

The possibility of monopoly gain through high and discriminatory rates supplies a genuinely economic motive to the persistence of official parities and incomplete *ad hoc* devaluations. Aside from this, the forces which prevailed against the readjustment of currency standards were more or less remote from a truly economic rationale: (1) exaggerated notions as to the increased real burden of foreign debts, (2) the pressure of protected industries, (3) inertia,

(4) the "face-saving" quality of the old parities, (5) belief in the adequacy of the trade and payment arrangements of exchange control to compete with the traditional liberal system of the creditor countries, (6) the complacency of totalitarian states with exchange rates which required extensive State interference in international trade and hence in private business generally. We may now proceed to review the consequences of exchange control, including overvalued exchanges and bilateralism, upon international trade.

INTERNATIONAL TRADE

No effect of exchange control surpasses in importance its reduction of the value of international trade. Observe first the outcome for exchange-control countries in the aggregate. The fall in their share of world trade from 27.19 to 22.53 per cent is sufficiently striking in itself, but as the League of Nations' economists pointed out, the actual fall would be much greater (1) if the overvaluations of exchange-control countries had not considerably

EXCHANGE-CONTROL COUNTRIES IN WORLD EXPORTS*

(Percentage share in total gold value of exports by groups of countries)

Countries	1929	1931	1935	1937
European exchange-control	23.48	27.19	21.68	22.53
Gold bloc	14.53	15.86	13.94	12.08
Others	61.99	56.95	64.91	65.39
	100.00	100.00	100.00	100.00

* League of Nations Report on Exchange Control (Geneva 1938), p. 30. The trade of the United States is not included.

exaggerated the value of their trade, and (2) if their intra-group trade had not proceeded at prices above world market levels.¹ These important modifications must be borne in mind when we turn to the countries specifically studied in these pages, not only for Germany and Hungary, but also for Austria, which withdrew successfully from exchange control, inasmuch as the statistics *understate* the share of non-exchange control countries. During the quadrennium 1933 through 1936, Austrian exports maintained a level of about 40 per cent of their value (and volume) in 1929,

1 Cf pp 25-26, 127-131, 242-270 above

whereas world exports for the four years ran at 35, 34, 35, and 37 per cent. This higher level was attained by Austria, moreover, despite the persistence of import and export prohibitions and quotas after the virtual disappearance of exchange control. By way of contrast, Hungarian total trade in 1937 and 1938 attained only to 94 and 81 per cent of its 1929 magnitude, while world trade in the two years reached 97 and 86 per cent respectively. German exports, which had accounted for 12 per cent of world exports in 1929, fell to 10 per cent in 1938, despite an extension of productive capacity over the decade.

A concluding section upon The Theory of Exchange Control will present a method for isolating the effects of bilateralism, over-valued rates, direct limitation of exports and imports, and other components of exchange control in actual practice. In the present connection these effects are mentioned briefly with especial reference to the volume of international trade of Germany and Hungary. Because *de facto* devaluations proceeded rather far in both cases, it would seem legitimate to ascribe a large measure of the shrinkage of trade to bilateralism rather than to overvaluation. In her relations with Southeastern European countries, Germany did indeed — by a variety of devices scarcely cognizable as economic competition — succeed in balancing some of these clearings upward. But, as we have seen, the outcome for her trade as a whole was still negative: the balance of trade in 1937 and 1938 was less than it had been in 1933, the volume of exports a smaller share of world exports, and the volume of imports only slightly increased. Had it not been for a strong and persisting favorable turn to the German terms of trade after 1929, export balances would not have appeared after 1931. The adverse developments of the foreign trade of Hungary were in general unrelieved by bargaining power and adroit strategy such as Germany's, and the change in terms of trade intensified, in place of offsetting, the difficulties as in the German case.

Bilateralism itself, even in the absence of wrong exchange rates, has a characteristic downward-balancing effect on bilateral exports and imports through narrowing the range of buyers' and sellers' choices, and decreasing the attractiveness of foreign as against domestic trade. Downward balancing tends also to propagate itself, as Ohlin has argued,¹ since if *A* reduces imports from *B*, *B* must reduce imports from *C*, and so on in a spiral. As in the case

¹ Ohlin, *op. cit.*, p. 95.

of most exchange-control countries, Germany and Hungary also suffered additional foreign trade reductions through the omission of transit trade and many services from the clearing process, and from a still further narrowing of buyers' and sellers' markets through the absence of important commercial countries, such as the United States, from the clearing network Furthermore, the direct interference of authority in the items admissible to clearings such as characterized German trade under the *Überwachungsstellen* was bound to reduce its economic value

In the case of Germany and Hungary, both natural export-surplus economies, the overvaluation of their currencies remaining after deductions for *de facto* devaluations engendered additional obstacles by reason of the inconsistency between rates of exchange and the quantities of exports and imports contemplated for the clearings Typically some inflexible ratio of bilateral trade was established and the phenomenon of uncleared balances put in its appearance Numerous examples of this situation have been encountered throughout the inquiry, but the result is always the same interminable delays in payment, interest losses, risks, interruptions of current trade for the liquidation of old clearings and the negotiation of new agreements, and the shrinkage of foreign trade It is noteworthy that in 1933, after the introduction of premia and surcharges which partly counteracted the overvalued pengo, and in 1936, after the drastic reduction of artificial discriminatory rates, Hungary experienced increases of her foreign trade far surpassing the contemporary improvement in world trade¹ The evidence is impressive, even if allowance is made for the good harvest of these years

Ideally, the constraining influence of clearings could be counterbalanced in large measure through the flexible prices of direct barter dealings, or through the flexible trade ratios contemplated in payment agreements It cannot be gainsaid that barter occasionally permitted trade to proceed when clearing transactions had come to an absolute *impasse*, nor that certain conspicuously successful payment agreements functioned better than did the clearings as a whole But in neither Germany nor Hungary were these mitigations of strict control permitted to go very far Authorities always strove to cub compensation or barter, because it sapped some of the most promising trade away from the clearings, con-

¹ Cf p 118 above

tributed to their unbalance, and let down the bars as to effective rates of exchange. Furthermore, the prescription of uses for Aski Marks deprived their quotation of its free character. Hungary witnessed a sudden enthusiasm for payment agreements under the caption of *Densenkompensation* in 1936, but there is no evidence of any real flexibility of agreed-upon trade ratios, and even the much praised Anglo-German payment agreement of 1934 required constant constraint upon imports by the German authorities to prevent departures from the desired 55:100 relation of the two countries' bilateral exports. As we have seen, the total trade of exchange-control countries lagged behind world trade, despite such imaginable offsets as barter and payment agreements. In concluding it may also be observed that "additional" exports, however great their usefulness in liquidating frozen accounts, have been found by our analysis to include many exports not additional in any but a legal sense of the term.

The reduction in value of international trade is the joint result of a deflection of trade from its most profitable channels and an alteration of its commodity composition. Under the first kind of change, the most notable result of exchange control is the growth of trade between exchange-control countries at the expense of others. The force of bilateralism causes this to be characteristic of both the exports and imports of exchange-control countries, but special circumstances may suspend or reverse the general movement on either side of the trade balance. Thus Austria, not herself a genuine exchange-control country after 1934-1935 and enjoying an essentially free rate of exchange, did not divert a larger share of her exports to exchange-control countries in 1937 than there had been three years earlier (77 per cent by volume in both cases), but she was able to secure a larger share of imports from clearing countries (81.4 against 63.9 per cent by volume). In Hungary the shares for neither exports nor imports changed very significantly, since the efforts of this country to divert exports toward the free-exchanges, while successful in other quarters, were largely, though not completely, offset by the increase of exports to Germany. German trade with exchange-control countries increased on both sides of the balance. The League of Nations summary for sixteen exchange-control countries in Europe¹ indicates that ten increased and six decreased the shares of their exports to countries outside

1 League of Nations, Report on Exchange Control, p. 53.

this group between 1934 and 1937, and that of the six, the five countries other than Germany experienced the decrease of exports yielding free devisen because their export share to Germany increased. Amongst European non-exchange-control countries, the evidence seems to be that some, as, for example, France, Italy, and Switzerland, increased their exports in bilateral clearings but not their imports (1931–1934)¹, whereas England, probably because of its more strategic commercial position, was able to reduce exports to exchange-control countries from 18.3 to 14.2 per cent (1929–1937).² Finally, it should be pointed out that extensive changes took place within the trade of exchange-control countries. Hungary's exports to Germany and Italy increased from 22.5 to 36.1 per cent of total exports between 1931 and 1938. Germany's program of bilateral balancing involved the sacrifice of her favourable balance with Western Europe, with which she had purchased raw materials from Latin America, and the vigorous expansion of exports in this quarter and a general trade drive in Southeastern Europe to compensate for the loss.

Nothing in the character of either bilateralism or artificially high rates of exchange produces other than random changes in the composition of international trade. Marked changes in the nature of exports and imports therefore reveal that exchange control has not been employed as a purely monetary and financial device. It has become the instrument or complement of protectionist or autarkic policy. In this capacity exchange control, because of its complete arbitrariness, does not lend itself to the analytical method of economics. So far as concerns its influence in the past, we observe one conspicuous result upon international trade — the drastic reduction of imports of finished goods and extension of imports of raw materials. This tendency requires the opposite change in the trade of other countries. If autarky becomes universal, it would seem to imply the virtual cessation of international trade in finished products and the reduction of trade in raw materials to the exchange of goods without close substitutes.

Aside from the opportunity it affords for State intervention in trade, aside from the embargo on exports of capital (enforceable

¹ League of Nations, *Inquiry into Clearing Agreements*, pp. 38–40.

² F. W. Paish, *The Effects of Foreign Exchange Control on British Trade*, mimeographed, International Institute of Intellectual Cooperation (Paris, 1939), p. 17.

in other ways), and aside from the "face-saving" quality of old parities, exchange control with its overvalued currency unit and the bilateralism thereby made necessary has no further *raison d'être* than a possible gain in terms and "total gain" of international trade. What has been the evidence of our inquiry as to this possibility in the cases of Hungary and Germany?¹

For both countries the evidence is fairly clear that the prices of goods bought and sold through bilateral channels were higher than world market prices. Statistics prepared by the League of Nations revealed that Hungary paid higher prices to exchange-control than to other countries in 1936 for wheat, flour, poultry, butter, eggs, malt, and rye, and these results for poultry, butter and flour have been proven to be characteristic of the control period. Data for coffee, coal, and cocoa beans, as samples of the import side, revealed higher prices to have been paid in the clearings than in the free relations.² For Germany, the Berlin Institute for Business Cycle Research compiled data for imports of wool, cotton, lumber, oil fruit and oil seed, petroleum and its derivatives, and copper, for the interval from 1933 to the last quarter of 1935. Prices were higher — in some cases very much higher — for imports through the clearings, and these results were confirmed by our investigations for cotton, wool, and copper over the decade 1929–1938. Information about the prices of specific export goods of Germany is lacking, but the investigation of German export prices in the clearing relations with Southeastern Europe revealed a general tendency for them to exceed the world level.

The explanation of these high import and export prices involves a number of factors analyzed in detail in the concluding section upon The Theory of Exchange Control, at present a brief statement must suffice. The overvalued exchange rates of Germany and Hungary in comparison with Western Europe account in large measure for high export prices received through the clearings. The overvaluation extended for both countries to certain Southeastern European countries, and in the case of Germany, it was fortified by monopoly and monopolistic discrimination, the exploitation of clearing indebtedness, and political pressure — all operating in the direction of high export prices. The high import prices, on the

1 The short duration of control prevented the instituting of a similar inquiry for Austria.

2 Cf pp 127–130 above.

other hand, run counter to expectations on the basis of overvalued exchange rates, which should lead to importing at bargain prices. But as the concluding section will show, the gain from the high rate on home currency stands against certain losses. Even if clearing arrangements extended to all countries, the range of importers' choice would be limited by the necessity of bilateral balance, but in addition, important countries remained outside the clearing network of both countries, and furthermore, the risks, formalities, and delays in payment for foreign exporters prompted them to add a price premium in sales to these countries. If the import price indices of Germany and Hungary are to be accepted at their face value, the cumulation of losses from causes such as these more than offset the influence of their high rates of exchange on the import side.

Whether the high import prices or the high export prices represented the stronger force should be discovered in the behavior of terms of trade. For Hungary the terms of trade fell under the influence of agricultural depression from 1925–1927 to 1934, and thereafter recovered to the 1925–1927 level only once, in 1935, by contraries, Germany enjoyed the advantage of industrial exports and high terms of trade throughout the 'thirties. We are thus confronted by a strong external variable which makes difficult the appraisal of the influence coming from exchange-control in isolation. To exclude this variable, as far as possible, we have compared Germany with England, another country of almost exclusively industrial exports.¹ This procedure revealed an excess of German over British terms of trade, small in comparison with the margin of overvaluation of the Reichsmark relatively to sterling, but enduring from 1931 through 1938. This margin has, however, to be discounted considerably for the concealed costs of trade through clearings, such as losses to exporters in delayed payments, and the technical costs of exchange control.

The final calculus must include not only terms but also volume of trade in order to reveal "total gain." In the case of Hungary the significant fact is the virtual surrender, in 1935, of attempts at monopoly exploitation and monopolistic discrimination through

1. A comparison of Hungary with Poland, the only country of comparable agricultural exports not under exchange control, was precluded by the heavy subsidies to exports prevailing there, and by the termination of free payments in the spring of 1936.

high and differential exchange rates, an action which must have signified the conviction of the authorities that the game was not worth the candle. Germany experienced her highest terms of trade as well as her most favorable export balances between 1930 and 1932, concomitantly with the heavy outflow of capital. If the "total gain" of trade was large in these years, it was transferred abroad for the most part to liquidate debts. After 1932 both the favorable terms and the volume of exports diminished. It is difficult to believe, if account is taken of the concealed costs of exchange control, that the high Reichsmark rate on balance actually netted any economic advantage in the international trade of Germany.

THE DOMESTIC ECONOMY

If the continuance of exchange control had its justification in political but not in economic terms, so far as concerned foreign trade, the total economic calculus becomes conclusively adverse if we include also the repercussions of the institution on economic life within the country. Exchange control in Austria and Germany protected the economically inferior agricultural lines of production, and in Hungary it fostered the economically weak industrial production. Amongst industries, there is clear evidence that larger producers and cartels gained at the expense of smaller producers and consumers. The allocation of devisen for imported raw materials, being a matter of administrative decision without possibility of legal redress on the part of entrepreneurs, fell under the influence of political and economic pressure, with the odds in favor of the largest firms and combinations. Trade under clearings and compensation required the services of skilled legal and commercial experts, which the small producer could ill afford. In compensation only large deals were economically possible.¹ Specific industries which enjoyed adventitious gains under exchange control in Hungary were cotton textiles, coal, lignite, firewood, petroleum, glass, leather, and paper.² For Germany it has not been possible to discover the separate influence of exchange control upon specific industries, economic policy embracing taxation, special levies,

¹ These effects have been emphasized in the case of Germany by Brockmann, *op. cit.*, p. 105 and Fischer, *op. cit.*, p. 42, of Czechoslovakia, by Sourek, in Mayer, Horna, and Sourek, *op. cit.*, p. 154, of Finland, by Hormi, *op. cit.*, p. 16.

² Cf. pp. 94, 107 above.

informal "voluntary" contributions, and the like merge inextricably with import and export regulations and the allocation of devisen. We have only the indirect evidence of profit ratios, as presented for example in the excellent study of Maxine Sweezey,¹ which reveals a relatively strong position of heavy industry, an intermediate position for light industries, and a disadvantageous situation for luxuries. The extent of cartelization is greatest in the first group.

To the reduction of the "social economic product" through the increase of monopoly are to be added, as costs of exchange control, the outlays of the State and entrepreneurs in maintaining the apparatus and carrying on business through its devious channels. These embrace not only the costs of technical advisers and the time and money expended by entrepreneurs in the "war of forms to be filled out," but also fees and bribes, to the State, the costs include the maintenance of the officialdom and clerical staff engaged in clearings, Control Offices and the like, and the expenses of negotiating agreements with foreign countries.² When clearings and barter arrangements are subjected to considerable changes, there is added the private and social costs of sudden alterations in direction of production.

It is sufficiently clear that the consumer, as Fisher writes, is the stepchild of exchange control.³ In Hungary real wages failed until 1938 to recover to the level even of the early years of depression, despite a notable increase in agricultural prices. For Germany, under an avowed policy of restraining consumption in favor of objectives ulterior to economic welfare, the standard of living — aside from the elimination of overt unemployment — seems to have declined. Wages were stabilized in general at their 1934 level, but the evasion of price maxima, the deterioration of quality, and the various deductions from money income combined to produce a lower real wage level.

THE THEORY OF EXCHANGE CONTROL

Exchange control in its most common form includes two main elements — the maintenance of more or less artificially high rates

¹ Maxine Y. Sweezey, "German Corporate Profits 1926-1938," *Quarterly Journal of Economics*, Vol. 54 (May, 1940), pp. 384-399.

² Over the span of three years, for example, England concluded eighteen separate commercial and payment agreements with Rumania alone, cf. Parish, *op. cit.*, p. 19.

³ A. G. B. Fisher, *op. cit.*, p. 14.

of exchange, and, since this produces a "shortage of devisen" in the control country, the resort to systems of bilateral trade-balancing to dispense with the necessity of trade by devisen. Each of the two characteristics has taken on a great diversity of forms, and the possible combinations of these forms are legion. Some countries adhere to overvalued rates, some have admitted rates near equilibrium, some maintain a unique exchange rate, others resort to discriminating multiple rates, bilateralism includes part of the world, while a part is still multilateral, in some cases bilateralism is secured through barter, in others through clearing and through payment agreements, some countries engage in barter and clearing without themselves prohibiting capital exports, and without maintaining official exchange rates, multilateral clearings are not unknown, but their number is limited. We shall proceed most effectively if we start with somewhat simplified or "idealized" conditions and approach reality by degrees. It seems advisable to consider bilateralism first and overvalued exchange rates subsequently.

A *An Ideal World of Bilateral Trade*

Let us begin by comparing a universal system of international trade by barter (or compensation) with a system of trade permitting free use of bills of exchange. This comparison can be carried forward in a realistic setting without resort to rarified abstractions by assuming that transportation costs, protective tariffs, quotas, and import and export prohibitions are in existence, but are not changed by the substitution of barter for trade by means of bills of exchange. Assume that exporters and importers were free within the limits of the State interferences mentioned to maximize their economic positions in view of the underlying cost and demand functions, and that the same freedom now exists under barter. If traders were permitted to "barter" not only goods for goods, but also goods for services, and goods and services against evidences of debt, and if, as we suppose, all countries are open to barter dealings, the difference from a system of multilateral trade by devisen would be simple but dramatic. It would be precisely analogous to the successful suppression of monetary exchange within a country, and the reduction of sellers' and buyers' economic positions would be measured by the material and psychic costs of arranging the "double coincidence" requisite to all barter. But as it is understood

in exchange-control countries today, "barter" or "compensation" does not admit the exchange of services or of capital, but only of commodities, bilateral trade which does include these items goes by other designations, such as clearing and payment agreements Upon this more realistic interpretation, barter entails a reduction of economic product, not only by the costs of arranging "double coincidences," but also by the economic gains arising from the international purchase and sale of services and from borrowing and lending

We proceed to the considerably more complicated devices of securing bilateral balance through clearings These devices fall into two large groups, accordingly as State action to force bilateralism impinges upon the rate of exchange or upon the quantities of exports and imports which enter the clearings A further subdivision depends upon whether capital movements are not or are provided for, that is, whether trade is forced to a 1 1 ratio, or whether some other ratio is adopted The most simple system with which to begin is one achieving the bilateral balance through an authoritarian exchange rate, and which at the same time, while leaving the initiative as to exports and imports entirely to traders, does not provide for capital transfers To secure a 1 1 ratio of exports (or imports) between the two countries, the exchange authorities must agree to lower the rates of foreign exchange in the favorable-balance country and raise them in the unfavorable-balance country Pushed far enough, save for one case which can be neglected,¹ this device will achieve its aim What are the economic consequences?

The method of inducing bilateral balance by means of the rate of exchange is adopted as the simpler and more nearly "ideal" for expository purposes,² not only because the change of the rate of exchange is a uniform and objective fact for all traders, but also because it limits the possibilities of changes in exports and imports which could ensue As we have previously remarked, so far as concerns arithmetic, balancing might follow if both sides increased, the deficient side (exports or imports) increasing faster, if both sides decreased, the excessive side (exports or imports) decreasing faster,

1 Cf p 326, n 1

2 This method would also be simpler in *practice*, but States have usually resorted to direct operations upon the volume of exports and imports, because *inter alia* this affords the opportunity of regulating, not only the *quantity*, but also the *composition* and *direction* of trade

if the deficient side rose to the (unchanged) excessive side, or the excessive side fell to the (unchanged) deficient side, or finally if the excessive side decreased and the deficient side increased. But if balancing is achieved through exchange-rate manipulation, the possibilities included in the first two of the foregoing series of conditional clauses are clearly eliminated. For the reduction of the rates of foreign exchange in the favorable-balance country does not make exporting *more* profitable, nor does the rise of rates in the unfavorable-balance country make exporting *less* profitable.¹ Consequently the rate adjustment necessary to work toward bilateral balancing cannot possibly increase bilateral exports and imports above the level of the larger of the two (for one country in a bilateral relation), nor by the same token reduce them below the level of the smaller. We are able, therefore, to put the question of effects in a somewhat narrow form, as long as we are dealing with bilateral balance obtained through the rate of exchange. Will the bilateral balancing be achieved by an upward or a downward balancing, i.e. will the exports of the former unfavorable-balance country rise to the level of the exports of the former favorable-balance country, or will the imports of the former unfavorable-balance country fall to the level of the former favorable balance country? For the balancing to be upward the demand for exports of the favorable-balance country in the clearing partner must not have *more* than unitary elasticity. If it did, the fall of the exchange rate in the favorable-balance country would reduce its total export value, and this is a movement in the direction of bilateral balancing downward.

In order to investigate the possibility of such a situation, however, it is necessary to know the trade situation of the unfavorable-balance country, not merely with one country, but with all its trading partners. It would merely postpone meeting the crucial

1. We need not be disconcerted by the theoretical possibility, mentioned in treatises on foreign trade, that elasticity of demand for exports as a whole might be *less* than unity. If such a demand existed, no decrease of the rate of exchange in the favorable-balance country could reduce its favorable balance, and no increase of the unfavorable-balance country could remove its unfavorable balance. But we may be almost certain in the case of an individual export that this would not be allowed to happen by the traders themselves — that a greater volume of exports should be marketed at a smaller aggregate yield — since the exporting firms, if not the domestic producers, are usually few and would exercise oligopolistic restriction. Furthermore, examples of such a demand for individual products are limited by reason of foreign competition, and the existence of an aggregate demand of less than unity seems never to have been observed in practice.

issue, if we did not assume at once that unfavorable balances are characteristic for our "unfavorable-balance" country's entire situation. In order to increase exports (in the particular bilateral relationship with which we began) to the level of the favorable-balance country, the unfavorable-balance country will have either (1) to deflect its exports from other countries or (2) to increase its total output of exported goods. The former course would *intensify* the necessity for downward balancing in its bilateral relations with all the "other" countries. The latter course will raise the cost of production of exports,¹ since it will be necessary to pay higher rates at home, or to import them at higher costs also. Because the yield of exporting is increased by the State revision of the exchange rate to induce bilateral balancing, the unfavorable-balance country will be able to incur higher production costs for exports and yet export more. As exports increase, marginal cost is forced upward, not only by higher costs of factors, but also by an underlying technical inefficiency, for it must not be forgotten that this is an "unfavorable-balance" country aside from the new bilateral rate of exchange, while the rise of costs in the unfavorable-balance country makes increasingly improbable the maintenance of unitary effective demand on its part for the favorable-balance country's exports. The rise of costs would normally tend to deflect some demand within the unfavorable-balance country to foreign markets, but under bilateralism this reaction is thwarted by the enforcement of sufficiently high foreign exchange rates within the country to discourage imports in the unfavorable-balance relations generally. Meanwhile developments in the latter are tending to reduce its demand for the other country's products, no matter what the demand elasticity may be; the increased demand for factors of production in the unfavorable-balance country tends to raise costs of production in the favorable-balance country and to decrease exports. Inasmuch as these restraining forces become the stronger the more is exported by the unfavorable-balance country, the *a priori* probabilities of a complete balancing are small. *Mutatis mutandis* it is demonstrable that a complete downward balancing is improbable, and that resistances to a decrease of exports by the favorable-balance country increase as this limit is approached.

The results of balancing at any point *between* the upper and

1 Unless there are unemployed factors at home, with which contingency we shall deal presently.

lower limits may be translated for each country as follows. For the favorable-balance country the increase of the foreign value of its money means a favorable change in the terms of trade, a decrease in exports and a smaller gain upon them, but imports are cheaper and larger, and the gain upon them is greater. For the unfavorable-balance country the decrease of the foreign value of its money means an unfavorable change in the terms of trade, a decrease in imports and a smaller gain upon them, but exports are cheaper and larger, and the gain upon them is greater.

Can no more be deduced than this? If not, we should be unable to say whether the "upward-balancing" or "downward-balancing" force of bilateralism is greater. We should similarly be unable to say whether the favorable-balance country's gain on imports does or does not exceed its loss on exports, or whether the unfavorable-balance country's loss on imports does or does not exceed its gain on exports. If the upward and downward balancing forces neutralize one another, the volume of world trade is not affected; exports (imports) in the aggregate remain at their former magnitude, a preponderance of the upward-balancing forces causes exports (imports) to increase, and a preponderance of the downward-balancing forces causes them to decrease.

The foregoing tedious and inconclusive description of possible behaviors of terms and of export and import magnitudes does indeed belong to the *modus operandi* of bilateralism, but has not answered the crucial question. The answers are, in fact, given by a simple calculus of utilities and costs: importers are no longer able to purchase in the countries with the lowest domestic costs of production, nor are exporters able to sell to the countries with the highest domestic demand. Importers purchase, of course, where it is *now* cheapest, and exporters sell where it is *now* dearest. Since the advantages of exporting and importing, on the whole, have been reduced, the volume of international trade will fall. The narrowing of the field of buyers' and sellers' choices entailed by bilateralism reduces the favorable turn which bilateral balance required of a favorable-balance country's terms of trade, and it makes still more unfavorable the unfavorable turn required of an unfavorable-balance country's terms. For a "typical" country, with neither favorable nor unfavorable balances, the terms of trade are less favorable and, with anything less than unitary elasticity of demand for its products, the total gain is also smaller.

Bilateralism inevitably balances downward, even in the case just treated, which involved no direct interference of authorities with *kinds* of exports and imports, and no reference to autarkic tendencies

A sceptic of this conclusion is invited to contemplate the fact that the final ratio of exports to exports (or imports to imports) between the two countries involved in bilateralism is the result of an *entirely arbitrary* decision. If it could be shown, for example, that balancing of a ratio of 1:1 could by any stretch of the imagination produce a higher gain and volume of trade than the "natural" condition of unbalance between exports and imports, then it ought to be possible, by the same token, to make such a demonstration for a 1:10 ratio, or for 1:100, or 100:1. In other words, a position opposed to the one represented in the foregoing paragraphs would be tantamount to maintaining the thesis that any arbitrary decision as to the direction of international trade will increase the gain and volume. Such a thesis, indeed, would have to be maintained if bilateralism were defensible on economic grounds.

It must be made quite explicit, however, that the reduction of gain and volume is asserted for the "ideal world" as a whole, or for a *typical* country, not for *every* country. The shifting of reciprocal demand throughout the system as a consequence of the imposition of bilateralism is almost certain to shift the demand schedule as an entirety for the products of some countries to the right. A certain limited number of countries can experience an increase of total gain (and perhaps also of volume) from international trade. But it is not to be imagined that this occurs as a result of these countries' own efforts, nor *pro tanto* of their exchange control. The gain is a windfall.

Thus far we have carried on an analysis on the basis of a 1:1 ratio of bilateral trade, that is, with the elimination of capital movements. But does not the conclusion regarding downward balancing depend upon this very assumption? If under clearing a 2:3 ratio is set between the exports of one country and another, it means simply that the country with the unfavorable balance is accepting a certain fraction of the current inflow of the other country's exports as repayment on a past loan or as a new loan. The concept of a "tied loan," long familiar as an unusual case under *devisen* trade, describes *all* loans under bilateralism—the proceeds can only be "used" (they are indeed obtained) in the goods

of the lending country. Just as it would be open to the borrowing country under a tied loan to re-export the products of the lender to third countries in an effort to escape the limited range of choice imposed by the contract, so in bilateral trade a receiver of "capital" may re-export to third countries. The process diminishes losses to the borrower from having to take goods and services which he would not have taken or could have purchased more cheaply elsewhere. But some loss remains. For third countries, it may safely be assumed, have already had the opportunity of purchasing the lender's wares and will take more only if the price is reduced. This loss of a "tied loan" also characterizes the loss of a *repayment* under bilateral balancing, and indeed of *all trade*. It is apparent now that the reduction of "total gain" of international trade under a 1:1 clearing agreement has precisely the same character as the loss at any other ratio. In passing, it will not escape the reader that under bilateralism any movement of capital *must* be on the initiative of the State, which determines by means of the clearing rate of exchange (or otherwise) the volume of exports relatively to imports.

Thus far we have proceeded upon the assumption that the authorities secure bilateral balancing at the desired ratio by manipulating the rate of exchange, while leaving the quantities and kinds of exports and imports entirely to free choice. Now let us reverse the assumption: the State regulates exports and imports directly, leaving the rate of exchange to competitive forces.¹ Contrary to the case of bilateral balance secured through fixing the rate of exchange,² the State can undoubtedly, by a system of quotas, tariffs, bonuses, and penalties, either increase or decrease *both exports and imports* at the same time, and it can undoubtedly bring them to equality or to any ratio desired. A system of prohibitions, quotas, tariffs, subsidies and taxes can undoubtedly expand the physical volume of exports and imports. Pressed far enough with sufficient sacrifice of terms of trade, it can also expand the value of imports and exports, as Russia has done since the Revolution. But if producers and consumers have maximized their economic positions, all such devices must produce a shrinkage of value of output as a whole. Exception should be made, as in the rate-of-exchange device, for windfalls in the form of increased intensity of demand for the prod-

¹ As a matter of fact, both tacks have usually been taken at once, but the possibility of *inconsistency* between the two precludes this case from consideration in an "ideal" world of bilateralism.

² Cf p 325 above

ucts of one or a few countries in a world where international trade is dislocated by quantitative interferences, but even this outcome is not the product of the country's own interferences. Finally it should be observed that, though direct interferences can increase the volume and value of exports and imports (albeit typically at a loss in output as a whole), the "optimum" interferences themselves are ideally based on a practical omniscience of demand and supply functions of particular goods in international trade and the repercussions of bilateralism on these functions. With human limitations, the authorities may be able to extend the value of trade only with a very heavy cost in general efficiency.

Obstacles to international trade are usually said to lower world market values. In a world of bilateralism no single currency could be used as a measure of international prices — indeed, truly international prices no longer exist. Resort might be had, however, to an index which embodied the price in each bilateral relation and weighted it according to the quantity sold in each relation. An index of this sort running back into the period of multilateral trade would certainly decline as bilateralism spread. Bilateral balance narrows the range of choice of both sellers and buyers, the former would, on the average, obtain lower prices, and the latter would, on the average, have to pay higher prices, but the fall of export prices would exceed the rise of import prices, because the attractiveness of foreign markets in comparison with domestic markets would be decreased for both exporters and importers by the limitation of bilateralism.

Three matters which might conceivably affect the outcome of the argument to this point have been passed over in a cavalier fashion and must now be scrutinized: unemployed resources, obstacles to trade, and money capital movements. Could not the existence of unemployed resources in a former unfavorable-balance country permit it to extend production so as to "balance upward" when bilateralism is imposed? An affirmative answer is clearly warranted: the rise of export costs would be held in check. But if the unemployment occurs, instead, in the favorable-balance country, the situation is reversed. Unemployment reveals the presence of downward wage-rate inflexibility. When exchange rates are lowered in the favorable-balance country to reduce its export balance, if costs are inflexible the reduction will not have to be large to reduce exports considerably. The unfavorable-balance country

obtains only a small bonus for its exports from the slight upward revision of exchange rates, and extends exports only slightly. The balancing is mostly downward. Since there is no presumption that unemployment is more extensive amongst unfavorable-balance than amongst favorable-balance countries (compare England and the United States), the conclusions regarding bilateralism are unaffected.

The imposition of bilateralism, by reasoning given earlier, acts as a protective tariff on unfavorable-balance countries and as a system of export tariffs on favorable-balance countries. If the favorable-balance countries in general occupied their position because of the importation of raw materials for fabrication and re-export, bilateralism would be accompanied by one change tending to offset its downward-balancing force. For the export of finished goods would be reduced, unfavorable-balance countries producing more for their own consumption, and, in general, tariffs, quotas, and import prohibitions are not as severe for raw materials as for finished goods. But favorable balances arise frequently from exporting raw materials, and here the factor mentioned works to intensify downward balancing.

A third point concerns movements of capital in money and goods. It was remarked in the paragraphs dealing with barter that if it admitted money and securities, "barter" in this sense would be identical with multiangular trade with devisen. The same is true of clearings. The earmark of both is the *exclusion* of these items. But clearing, unlike barter, can be conducted so as to transfer real capital. Thus far in history, clearing and payment agreements have been used most frequently to repay existing obligations, and clearings have served as the channel of "involuntary" lending and borrowing through the accumulation of uncleared balances. Neither class of capital movement can be regarded as "economic" in character, that is, as representing the response to interest-rate differentials. In any event, to be used to transfer capital, clearing and payment agreements require an authoritarian "fixing" of the exchange rate or direct regulation of exports and imports in order to develop a balance in the desired direction and a balance of the desired size. In a section describing the functioning of bilateralism in an "ideal world," we can appropriately observe merely that political authorities *may* direct the flow of capital internationally to its most productive applications.

In summary, we have discovered that bilateralism, even under the most ideal circumstances imaginable — without State interference in the items of international goods and services trade, without exchange rates incompatible with the ideal of bilateral balancing, and with the whole commercial world embraced in the scheme — in all events results either in downward balancing and the reduction of the total volume and gain of international trade or in an increase at the expense of total output. An individual country — not typical of all countries, however — can experience, as a pure windfall, an increase in the demand for its own products sufficient to offset any losses to it produced by bilateralism, and it might even gain on balance.

Barter presents the greatest reduction of gain in world trade¹, clearing without possibility of capital movement comes next, and clearing and payment agreements providing for capital movements, if they are used to transfer capital from lower to higher productivities, come next. All devices at their "best" sacrifice economic efficiency, and they are all discriminatory, for they do not operate to give the market to the most efficient seller and to the highest bidder, but to make exports equal imports for each pair of countries.

There is a categoric difference between all of these bilateral devices, on the one hand, and a system of multilateral trade, on the other, whether the latter is envisaged in its traditional free-devisen form or as a system of multilateral clearings. Referring to exchange control and bilateral trading, one author writes:

"But to the extent that a scheme of this sort is perfected — made flexible and inclusive, providing, for example, as its propounders have suggested, for a rise and fall in the value of the 'checks' on a certain country to bring demand and supply into equilibrium, and providing for loans and capital investments — it becomes more and more like the regular international money system, with the same advantages and the same trouble."²

As a matter of fact, however, there is an absolute limit reached to the process of becoming "more and more like the regular international money system," even if, as the foregoing paragraphs have demonstrated, the rate of exchange accords perfectly with the equilibrium of supply and demand desired under bilateralism, and even if capital is moved to points of highest productivity. The

1 There are occasional exceptions, cf p 317 above

2 Eugene Staley, *World Economy in Transition* (New York, 1939), pp 243-244

capital is still a tied loan, and exports and imports are tied as to source and destination. To progress farther than this is to surrender *bilateralism* at any ratio of balances. *Multilateral* clearing is a horse of a different color. Where it has existed, as for example in the "Brocchi" system and otherwise,¹ it constitutes a small island of free payments, for the ratios of exports and imports do not have to be set in order that it may function. Balances are for free disposal through the system, however large or small it may be. For this reason the enthusiasm once displayed by Einzig for a world (multilateral) clearing system is curious, for such an arrangement is simply a reconstitution of what Staley calls the "regular international money system" under slightly different auspices.² Let us not err, multilateralism is one thing, bilateralism another.

B Actual Bilateral Trade

We must now take account of certain important institutional factors which reduce the gain of international trade under bilateralism even below the level of a "perfect" system. Actual bilateral trade is less efficient, in the first place, because of its incompleteness. The incompleteness narrows the market for both exporters and importers, and tends to make imports cost more and exports bring less. Furthermore, even within the areas covered by bilateral trade, certain marked shortcomings of bilateralism are caused by its not being the universal system. The two great shortcomings are its exclusion of transit trade and of many services. If all countries do not belong to the series of bilateral agreements of a given country, it is forced to exclude transit trade from all its clearings, in order to avoid their being used for trade which actually belongs by origin or ultimate destination to a non-clearing country. This result is quite properly stressed by the League of Nations' Enquiry and its Report. Indirectly the incompleteness also frequently results in the exclusion of many services, for "invisible" items to the customs house are almost equally "invisible" to the exchange-control authorities. Capital flight by means of fictitious deals through the clearing accounts would be difficult to apprehend, and the exchange

1 Cf p 16 above. Germany, Greece, and Japan had such an arrangement, cf. Blockmann, op. cit., p. 121. In most cases, however, the system labored under artificial rates.

2 Paul Einzig, *The Exchange Clearing System* (London, 1935), Chapters XX and XXI.

authorities usually make short shrift of the matter by excluding services except those easy to control, such as services to travellers, to regular business representatives, and insurance and bank commissions. The "downward balancing," through eliminating transit trade and many services, seriously reduces the volume of international trade.

Except for the possibility of monopolistic selling of exports (including monopolistic discrimination) and monopsonistic purchasing of imports, any departure of the composition and amount of exports and imports from their condition under competitive buying and selling produces economic loss. Bilateralism in itself, according to the argument of the preceding section, produces such a loss, even where the interference of the State does not go beyond the exchange-rate adjustment essential to bilateral balancing. But the fixation of an exchange rate is at least objective and, in comparison with other devices of securing the balance, less discriminatory amongst particular exports and particular imports. "Theoretically" it is, of course, possible to secure precisely the same penalty or bonus on each item of import and export as is produced by the movement of a unique exchange rate by a complicated system of specific import and export tariffs or of quotas, domestic price-fixing, consumption or use taxes, and export bonuses. All of these have been utilized in the 1930's, together with even cruder measures, such as import and export licenses, rule-of-thumb administration as to what is a "necessary" import, what an "indispensable" export, and even the mere arbitrary selection of tariff-schedule items such as to add up on the import and export sides to equality.¹ The point scarcely needs to be argued that even the more refined methods are too complicated to administer without discrimination against certain items of exports and imports, and with others no pretense is made to the contrary. The probability amounts to a practical certainty that such measures achieve bilateral balancing with a heavy cost, peculiar to themselves, in economic efficiency, on the selling and buying sides alike. Furthermore, they are often used in conjunction with a half-hearted adjustment of exchange rates intended to aid in the balancing.² But whether the price attack through the

1 Cf. Jacques Bataille, *Les offices de compensation leur rôle dans la restauration du commerce extérieur* (Paris, 1934), Ch. VIII, Margaret Gordon, *op cit*, Ch VI.

2 Cf. pp. 86-87 above.

rate and the quantity attack through direct measures work in all cases in unison and after any discoverable rationale could not be known even by a Minister of the National Economy

The gamut of contra-economic interferences in international trade connected with bilateral balancing is not complete until we have named protection, autarky, totalitarian control, and political skullduggery, both at home and in relations with other countries. These are admittedly not necessary parts of bilateralism, but it is well to bear them in mind in any attempt to appraise the results of the system in its actual operation. Finally it must be emphasized that the reductions in volume and gain of international trade imposed by the four "institutional" factors pointed out in the present section — absence of clearings with some countries, exclusion of transit trade and services, awkward and discriminatory direct regulations of the volume of exports and imports, and outright protection, autarky, and political maneuvering — all these losses are not only additive to the net loss in an "ideal world" of bilateral trade and to one another, but they are also cumulative.

C Exchange Rates under Exchange Control

Save for such rare cases as Austria after 1935, where exchange control was attenuated to an embargo on capital exports, all systems have involved overvalued rates of exchange. The theory of exchange control must embrace generalizations concerning the meaning of overvaluation in this context, its effects upon trade, and upon prices.

At the outset it is necessary to distinguish nominal from real overvaluations. The nominal or official rate of exchange by no means lacks significance, for its preservation represents one of the primary aims of exchange control and necessitates the whole apparatus of bilateralism. Nevertheless, effects upon trade and goods are produced only by the exchange rate or rates over which goods are actually exported and imported, and consequently in the ensuing investigation of these effects, the word "overvaluation" must in all cases be understood to refer to real rates. Such real rates include rates of exchange given by the prices of frozen accounts applicable to exports, special categories of currency such as Aski Marks, and the effective rates employed in compensation, clearings, and payment agreements.

The concept of overvaluation applicable to relations between

non-exchange-control countries differs rather strikingly, at a superficial level at least, from that applicable to relations between exchange-control countries. Definitions of equilibrium rate under the former situation, such as those proposed by Cassel, Pigou, and others,¹ quite correctly run in terms of the prices of goods and services, but under exchange control, involving as it inevitably does the imposition of bilateral balancing, the equilibrium rate is that rate which causes exports to equal imports in trade with a *particular* country or to stand in some other fixed relation predetermined by authority. It is precisely this contrast which requires the authorities to use force, either upon the market rate of exchange or upon the quantities exported and imported. But while it is quite correct to regard the exchange rate necessary to effect bilateral balancing with a particular country at whatever ratio of exports to imports the State selects as the equilibrium rate for bilateralism,² nothing precludes the use of a more fundamental concept even for bilateralism. It is indeed indispensable from an economic angle to know whether the balancing rate itself does or does not conform to price equilibrium. In this event the traditional concepts, such as Cassel's and Pigou's, come into their own again as measures of the real or economic disequilibrium of a rate of exchange which authority has imposed upon the trade with a particular country.

It may be convenient to refer to these two equilibria as price (or economic) equilibrium and bilateral equilibrium. How essential such a distinction is, appears from a non-exchange-control country, such as England before the present war, which nevertheless was the clearing partner of exchange-control countries. So far as concerned other non-exchange-control countries, it would probably be correct to assume that market rates on sterling conformed to price (or economic) equilibrium. So far as concerned the pound rate in the currency of an exchange-control country, this was not always the case. The payment agreement between England and Germany contemplated a fixed relation of English to German exports in their mutual trade at a ratio of 55 100, but because English exports persistently outstripped this ratio, the German authorities had always to intervene with direct limitation of imports from England, to prevent the accumulation of uncleared

1 Cf pp 233-234 above

2 This was the usage in the two preceding sections

Mark credits to English account¹ Sterling was undervalued from the angle of bilateral equilibrium. If we seek an explanation, we discover that the undervaluation did not arise because English prices lay below the level of free-payments countries, but because German prices exceeded it. Whatever terminology is used, the distinction between the two sorts of equilibrium has always been inevitable in analyzing the rates of exchange-control countries. Was the pengo overvalued or undervalued? According to the present terminology the answer would be the pengo was overvalued on the basis of price equilibrium, but undervalued on the basis of bilateral equilibrium with Germany. These facts may be, and indeed have been in the course of the present study, set forth in the more laborious terminology of price-equilibrium throughout. Thus it would be necessary to explain that at the Hungarian official rates, even as modified by the surcharges and premia on free-currency countries, the pengo was overvalued on the basis of Hungarian and "world" prices, this *reduced* the Hungarian favorable balance to free-currency countries, but at the pengo-Mark clearing rate, the pengo was undervalued on the basis of Hungarian and German prices, Hungary experienced an accumulation of Mark balances from the *stimulation* of its exports to Germany. In a theoretical discussion it may be desirable to have a convenient shorthand for all this.

What, now, are the economic effects of the two sorts of overvaluation? As a preliminary observation, it may be said that only by accident does bilateral equilibrium coincide with price equilibrium. The establishment of such a ratio as 1 5 1 for Hungarian and Austrian exports in the clearing agreements of these countries, and of a 100 55 ratio for German and English exports in their payment agreement, was undoubtedly motivated by the desire to incorporate into the bilateral system something approximating the ratio of exports which had existed under free currencies and a price-equilibrium rate of exchange. But the preservation of the bare export ratio signified nothing in itself, for meanwhile the price-equilibrium changed entirely through disparate monetary developments in the two countries. By accident, the currency depreciations of Austria and Hungary between the summer of 1931 and June, 1935, were approximately equal, and the clearing operated without large one-sided balances. If a given bilateral ratio were

1 Cf p 215 above

maintained with iron resolution for a very long time, it might be argued, and if factors of production moved rather freely from one country to another, the price or economic equilibrium would eventually be adjusted to the official bilateral equilibrium, their coincidence would then be more than accidental. The unreality of both the necessary postulates warrants neglecting this contingency entirely.

The literature of international trade and finance has set forth in sufficient detail the consequences of exchange rates higher than price equilibrium, and the main results, falling exports and rising imports, are not otherwise for exchange rates in excess of bilateral equilibrium, if we take the magnitude of exports and imports at bilateral equilibrium for the point of comparison. But for overvaluation relative to bilateral equilibrium very different results appear, *so far as concerns the aims of bilateralism*, from countries with export and with import surpluses. Following the argument of Section A, bilateral balancing in the direction of equality¹ of exports between the two countries requires a certain lowering of foreign exchange rates in a favorable-balance country. If the authorities enforce still lower rates, overvaluation exists relative to the desired bilateral equilibrium, and the former favorable-balance country now experiences an import surplus.² For a country which had an unfavorable balance, on the other hand, foreign exchange rates must rise to a certain level to produce bilateral balance. If the exchange rates are kept below this level, the resulting overvaluation tends to prevent the desired change, pressed far enough, it might leave trade altogether at its old balance or even intensify the former one-sided balance.

This reasoning explains what upon first consideration might appear to have been an anomalous situation. Central European countries chronically incurred *adverse* clearing balances with Western European countries, despite the fact that the trade of the former had regularly shown export surpluses resting upon non-capital items. With the institution of clearings, the overvaluations of the Central European countries changed their former bilateral export surpluses to import surpluses. Had the overvaluing coun-

1. The argument does not apply to *increasing* the disparity between two countries, but this is never an aim of bilateralism so long as its existence rests on a desire to conserve *devisen*.

2. In the absence, of course, of offsetting direct quantitative limitations upon imports.

tries formerly possessed unfavorable balances, their overvaluations would have permitted this condition to continue to a greater or less degree. Though the unfavorable clearing balances would have *appeared* to be less anomalous, in reality they would have been just as incompatible with the aim of bilateralism as they were in the first case.

A country with overvalued currency relative to bilateral equilibrium always accumulates debts in clearings, unless direct action is taken to interfere with the process. Thus the accumulation of clearing debts or balances exceeding a capital transfer contemplated in the terms of a payment agreement means *per se* that the debtor country's exchange is overvalued in this relation, but the absence of one-sided balances does not *per se* reveal that the exchange-rate conforms to bilateral equilibrium. Only if the exchange rate itself were the only instrument used in controlling trade would this be the case. Tariffs, quotas, import and export prohibitions, and licensing systems can be, and usually are, employed to supplement the exchange rate. If the entire apparatus does not avail to produce the desired forcing of trade away from the channels it takes under economic motives, there are four possible results. The official ratio may be revised to closer approximation to the actual movement of goods. Occasionally clearing agreements provide the steps for taking care of unliquidated balances.¹ Both these results obviously represent sacrificing the contemplated ratio of bilateral trade. The results most compatible with strict adherence to the letter of the law are (1) the authorities simply close the clearing until the debtors (importers) have paid a levy sufficient to liquidate the balance, or (2) the authorities do nothing at all, and simply allow the interminable delays in payments to exporters to throttle off their efforts to sell. Frequently the central bank has assumed the risk and part of the interest burden of clearing debts, but this again represents a letting down of the bilateral bars. Interruption of trade, the uneconomic application of balances, and risk and interest costs are involved in all methods of coping with one-sided clearing balances. Overvaluation is thus always potentially and must frequently be in fact a net addition to the forces of bilateralism named at the conclusion of Section B as operating additively and cumulatively to decrease the volume and gain of international trade.

1 Cf Margaret Gordon, op cit., Ch VI.

As we approach the concluding topic of this theoretical analysis, it is well to observe that overvaluation under exchange control promotes the growth of monopoly within the controlling country. Free payment countries, such as England, feel precisely the opposite effect from overvaluation—the stimulation of imports exposes domestic producers to more intense foreign competition and tends to disintegrate domestic monopolies. Why is the effect reversed by exchange control? The answer is to be found in the rationing of *devisen*. Foreign *devisen* are always “scarce” for an overvalued-currency country under exchange control, because demand exceeds supply at the official price. This gives rise to a margin between costs of importation and domestic prices of imported goods. Windfalls of this sort, as we have seen in the cases of Austria and Hungary, foster monopoly.¹ This fact assumes some significance in subsequent pages.

The argument of Section A on “An Ideal World of Bilateralism” admitted the possibility that the reshuffling of sources of supply and sellers’ markets attending the introduction of bilateralism in large segments of the world’s trade could increase the intensity of demand for one particular country’s products, despite the general downward-balancing tendency of bilateralism as a whole. It is not inconceivable, though scarcely probable, that a particular country should be able to envisage the results of bilateralism upon the demand for its products with sufficient clarity and accuracy to prompt it to foster the spread of bilateralism precisely because of such a gain. In most cases the ramifications of the system would be too complex for such a calculus, and the gain, if it appeared, would come as a pure windfall. But this is a different matter from the possibility of exploiting *given* demand schedules in international trade through monopolistic restriction of supply, either by means of a high rate of exchange or by means of discrimination through a multiplicity of rates. These not only can be but actually have been the objects of rate policy under exchange control.

Let us turn first to a high rate without discrimination. For the sake of formal precision, it may be pointed out that if the high rate is really possible without reducing the total value of exports (price multiplied by volume), the rate is still compatible with price equilibrium. If the State by virtue of its monopoly power over the

¹ Cf. pp. 57, 99, 106–111, 114, 154–155 above. In Germany, monopoly profits were closely limited by the State.

foreign exchanges under exchange control raises its rate successfully from its own angle — increases the total yield of exports — it is *not* overvaluing its currency, but simply obtaining the maximum value. Most writers have expressed the conviction that the elasticity of demand less than unity necessary to this operation is rarely or never found for a nation's exports as whole. In default of empiric verification of this opinion, we may accept it as an *a priori* probability. Statistical study of demand functions is still in its infancy and the complexities would be still greater for an international market. But the State export authorities may, by intuition and experiment, be able to discover elasticities of demand. For a country such as Germany, which exports highly fabricated and rather specialized manufactured products and imports raw materials, the maintenance of a rate above competitive price-equilibrium may be economically profitable from her own angle. The total volume of world trade, of course, shrinks, and, upon the basis of familiar reasoning, the gain to the monopolist will be less than the loss of others. The present state of information concerning international demand does not permit more than these observations.

Discriminating monopoly is another matter, for, whatever the elasticity, if the monopolist can carry through discrimination, he will increase his gains. Needless to say, the presence of a variety of *Sperr* currency categories and a multiplicity of clearings has already separated the buyers into different markets, and it is then only necessary to discover (1) whether the State in question enjoys monopoly advantages with some of these markets at least, and (2) whether intercommunication between the markets is sufficiently imperfect to permit differential prices. Export against émigrés' Marks by Germany clearly fulfills these conditions, and our analysis of German clearings with Southeastern Europe revealed instances of regional monopolies with successful monopoly discrimination.¹ Instances of monopsonistic exploitation were also not lacking, but, in general, monopsony is notably of less frequent occurrence than monopoly.

A sanguine view of the theoretical possibilities of discrimination is not tantamount to the conviction that it is practicable in many cases. To discover the necessary underlying conditions is difficult, and to administer the prices successfully is complicated and uncertain. A danger always exists that unscientific discrimi-

1 Cf pp 257-270 above

nation — charging one particular segment of the market more or less than the optimum price — may end by yielding less than a uniform price. Furthermore, small States stand under the jeopardy of foreign retaliations against discriminatory tactics. Hungary very largely gave up the attempt at discrimination by the end of 1935, but discrimination persisted in Germany and nearly all other exchange-control countries in Europe. In many cases it is difficult to determine whether this was by design or by the accident of differing currency depreciations in neighboring countries.

In view of the costs and numerous opportunities for loss set forth in the section upon bilateralism in practice and in the chapters preceding, it would be difficult to assert that even a successful instance of discriminating monopoly through exchange rate has ever covered the economic losses of exchange control even for that country. If occasionally exchange control delivers monopoly gains into the hands of domestic monopolists, the national dividend, augmented from one source, is decreased from another. By a fortunate accident a successfully discriminating country might also experience the windfall gain of an increase in demand schedules for its products, in consequence of the revolution in trade channels when bilateralism makes its advent. Such a combination might outweigh the costs of bilateralism, but if so, it would need to offset the loss of transit trade, of nearly all international exchange of services, and of profitable capital movements, the delays of payment and interruption of trade due to improper clearing rates, the costs of the exchange-control apparatus to the State and to private firms, and finally the economic costs of autarky and totalitarian interference, so far as these institutions are served by exchange control. In all events, discrimination reduces the yield of foreign trade for the other countries. But if it is unsuccessfully managed, or provokes strong retaliations by other nations, it adds to the already formidable array of economic costs for the exchange-control country itself.

D Exchange Control and Free Systems

1 Is Exchange Control an International Monetary and Trade "System"? Apologists for exchange control in the totalitarian countries confront economists of other lands with a paradox in proclaiming that the institution has created a system of "modern money," on the one hand, and that it discharges the same functions

as the traditional system of free payments, on the other. Certainly one would not be disposed to attempt resolving the paradox by denying the novelty of international payment and trade procedures under exchange control. But it is wise to examine the claim concerning the similarity of functions as it is put forward by these apologists themselves.

The following quotations show the progress of the argument as developed by Dr. Carl-Heinrich Müller, Oberregierungsrat in the Reichswirtschaftsministerium, in his Outline of Exchange Control:

"'Free-payment exchange' is a bank clearing. In a State clearing, the Clearing Office takes the place of the Reichsbank. This procedure corresponds completely to the main features of the so-called 'free' international payments" (p. 335)

"Through clearing the apparatus of international payments is only *technically* altered" (p. 337, Müller's italics)

"The clearing Mark cannot be used for third countries and can [be used] only for certain payments to the clearing partner" (p. 339)

"The most important difference between clearings (including payment agreements) and the former free world trade consists in the fact that freedom of purchase on the cheapest market at any time has been changed to a compulsion to purchase on certain markets" (p. 345, author's italics omitted)

"Most assuredly the world could arrive at a much higher level of material well-being, if it formed a world economy uniformly oriented to the viewpoint of the cheapest and best production" (p. 346)

"The way forward leads to new forms of the economic potentiality of trade, which are superior to those of the 'good old times' because they are capable of combining political direction of economic life with easier technical management" (p. 13)¹

If marginalia may be dispensed with in the case of Müller's argument, they would seem to be unnecessary also for the remarks of the German representative to the Conference on Exchange Control in Geneva, May 12-13, 1939. The representative is reported as saying, in substance at least, if not *verbatim*:

"exchange controls represent a new type of monetary economy" (p. 5)

"The real difference existing between the two systems is that in one there is the influence of the government in balancing the clearings and in the other the influence of the private entrepreneur in doing the same thing" (p. 9)

"In a 'free' country, the entrepreneur himself discriminates as to price or other conditions. The only difference really is that in Germany discrimination is official and in other countries it is private" (p. 8)

¹ C. H. Müller, *Grundriss der Devisenbewirtschaftung*, 2d ed. (Berlin, Vienna, 1939).

"it is impossible to make any sort of international cost calculations if the prices are established by the exchange control offices of two or more States In these prices fixed by these offices it is impossible to separate the two essential elements of this calculation (1) the price, and (2) the rate of exchange" (p 4)¹

In his extensive memorandum on exchange control written for the International Institute of Intellectual Cooperation, Dr Fritz Meyer holds that a bilateral system, complemented by premia for "additional" exports and export subsidies, leads to the same international adjustments as the traditional gold standard.² And yet he ventures the cautious suggestion — for what reason it does not appear — that arrangements should be made for the multilateral settlement of clearing balances.³ He dwells upon the benefits accruing to foreigners from the "fact" that Germany exports in order to import, and contrasts the German policy with that of other countries which are anxious to export but lack the incentive of an "autonomous economic policy" to stimulate imports.⁴ He seems to forget that in 1937 German imports were only three per cent higher than in 1932 and were 59 per cent lower than in 1929.

Finally we may well consider the question whether exchange control does or does not permit trade to move in accord with comparative costs. Cabiati appears to answer this question affirmatively,⁵ and Tasca⁶ negatively, but in fact the answers accord perfectly. Cabiati is concerned with establishing, contrary to the pretenses of exchange-control apologists, that, within the limits imposed by bilateralism, trade still responds to a profit-and-loss calculus, that "economic law" is not wholly superseded by "modern monetary systems." Tasca, on the other hand, emphasizes the fact that the very existence of bilateralism relegates to the discard the previously existing system of comparative costs established by more or less free competition, substituting therefor a regime of

¹ Geneva Research Centre, Provisional Record of the Conference on Exchange Control, Geneva, May 12-13, 1939, mimeographed (Geneva, May 22, 1939).

² Fritz Meyer, "Devisenbewirtschaftung als neue Wahrungsform," *Weltwirtschaftliches Archiv*, Vol 49, No 1 (May, 1939), n 466

³ Ibid , p 468

⁴ Ibid , pp 467-468

⁵ Attilio Cabiati, *Fisiologia e Patologia Economica negli Scambi della Ricchezza fra gli Stati* (Turin, 1936). I am indebted to Dr Gerschenkron for reading this book

⁶ Tasca, op cit , pp 159-160

costs which have resulted from the arbitrary actions of authority. That exchange control is a "system" no one would deny. But is it in any sense of the word an economic "system"? Walking backward is undoubtedly a "system" of locomotion.

(2) Are Exchange-Control and Free Systems Compatible? As exchange-control and other forms of State interference have increased during the past decade,¹ this question has become more and more serious for economists outside the totalitarian countries. Some have inclined to greater optimism,² others to greater pessimism.³ The answer is really one of degree or preponderance at either limit, the "other" system becomes impossible. In the case of exchange control this can be seen clearly by considering each one of its main elements in turn. If all the world but one (small) country places embargoes on the export and import of capital, the remaining country cannot maintain a free international capital market, but if only one (small) country decrees embargoes, the international capital market is essentially free. If all the world but one (small) country artificially raises exchange rates, the effects may largely cancel out amongst them, and the one (small) country is automatically a country of undervalued currency, but if one (small) country overvalues its currency, there is virtually no effect on the rest of the world. If all the world but one country imposes bilateral balancing, the remaining country's trade is bilaterally balanced, and one country's bilateralism in isolation cannot impose complete bilateralism upon any other country. If all the countries of the world but one regulate the composition and direction of their exports and imports, the remaining country has its foreign trade regulated for it, but the regulation of one (small) country affects the trade of the world as a whole but little. Between these limits, it is simply a matter of more and less.

While this way of envisaging the matter is unexceptionable, it

1 The percentage of imports covered by license or quota restrictions in 1937 for a number of countries follows: France, 58, Switzerland, 52, Netherlands, 26, Belgium, 24, Ireland, 17, Norway, 12, United Kingdom, 8, Sweden, 3, from League of Nations, *World Economic Survey, 1938-1939* (Geneva, 1939), p. 189.

2 E.g. Staley, *op. cit.*, Ch. X, "Problems of the 'Mixed' Economy."

3 E.g. Condliffe, *op. cit.*, Ch. IV, Tasca, *op. cit.*, Ch. XIII, "Systems of Commercial Policy. The Problems of Rapprochement", Haberler, *op. cit.*, Question III, "Is a Commercial System Economically and Legally Possible which shall guide Exchange between economically and politically predominantly Liberal and Interventionist States?"

may by implication present too favorable a view of the chances of free international payments for survival, for a small amount of regulation can overbalance a great deal of freedom. Thus if one country "freezes" the sums within its economy owing to foreigners, the governments of the creditors have no recourse — if there is to be any assurance of payment on *current* account — but to adopt a like measure. A very small country can force bilateral clearing for its mutual trade upon a very large country in just this fashion. A second reason for the superior force of regulation is its concentration in the hands of the State, whereas traders under the free system stand "naked and alone." Thirdly, as bilateralism spreads and foreign qualitative controls become more numerous, the economic data (costs, selling prices, foreign exchange rates) become less and less truly economic, and the ground is cut from beneath a system of free enterprise,¹ to a larger degree, it may be observed, than the mere loss of free-enterprise areas in a geographic sense.

For a number of years, and particularly in the most recent times, it has appeared that the question of compatibility is being resolved upon another plane than that of contrasting national economies. The growth of economic *blocs*, well confirmed statistically for international trade,² spells the perpetuation of exchange control and other forms of regulation between *blocs*, and very probably also the reduction of control between countries within each *bloc*. Whether the end effect upon the gain of international trade in these circumstances will be a rise or decline cannot be predicted, since it depends equally upon the severity of *inter-bloc* obstacles to trade and the liberality of treatment accorded to *intra-bloc* trade. There is furthermore the possibility of discriminatory measures as amongst *blocs*. If other *blocs* than that of the United States happen to be more or less *en rapport*, the observations made upon the rôle of a "small" country may be pertinent even to this large area.

1 Cf. Folke Hilgerdt, "The Approach to Bilateralism — A Change in the Structure of World Trade," Index, Vol X 8, No 116, pp 175-188.

2 Cf. League of Nations, *op cit.*, p 186. Between 1929 and 1938 the trade of the British Empire within itself as a percentage of its total trade underwent the following changes for imports, from 30 to 42 per cent, for exports, 44 to 50 per cent. Corresponding figures for certain other countries are for France, imports from 21 to 27 per cent, exports from 19 to 27.5 per cent, for Japan (Korea, Formosa, Kwangtung, Manchuria), imports from 20 to 41 per cent, exports from 24 to 55 per cent, for Germany (six countries of South-eastern Europe), imports from 4.5 to 12 per cent, exports from five to 13 per cent.

As the term is generally understood, "economic" describes the processes involved in maximizing utility from available resources. Liberal economists and contemporary socialist economists agree that this maximization is reached by the *free* choice of consumers as to their outlays on final products and by the transmission of these choices to the use of resources through the *competitive bidding* of producers, whether or not the producers are also owners. Exchange control in its contemporary form cannot be described as conforming to this test of what is economic. It is undoubtedly an instrument of control. But there is one question, which, if it ever comes to be seriously considered by the populace of exchange-control countries and economic *blocs*, will terminate both exchange-control and economic *blocs*. The question is an old one. *Quis custodiet?*

STATISTICAL TABLES

AUSTRIAN NATIONAL BANK

(Million Schillings)

	Note Circulation	Note Circulation and Sight Liabilities	Gold and Foreign Exchange	Private Discounts
	I	II	III	IV
1931				
I	904	1,092	868	118
II	873	1,027	830	93
III	879	1,009	833	71
IV	867	1,006	841	65
V	1,038	1,224	826	298
VI	1,050	1,286	699	488
VII	1,069	1,260	622	534
VIII	1,064	1,217	524	592
IX	990	1,163	456	605
X	1,057	1,208	351	744
XI	1,046	1,211	345	760
XII	1,091	1,271	337	835
1932				
I	1,034	1,222	295	853
II	992	1,161	268	854
III	949	1,123	249	841
IV	922	1,102	228	846
V	951	1,118	210	875
VI	912	1,075	193	850
VII	908	1,087	191	867
VIII	890	1,070	190	867
IX	857	1,069	189	855
X	849	1,071	189	324
XI	836	1,063	189	321
XII	880	1,098	189	355
1933				
I	822	1,059	189	327
II	792	1,037	189	297
III	839	1,046	189	302
IV	860	1,080	189	270
V	836	1,075	189	258
VI	831	1,078	192	245
VII	849	1,096	197	249
VIII	854	1,017	197	209
IX	882	997	197	205
X	899	1,029	197	223
XI	864	1,020	197	205
XII	913	1,055	202	237

AUSTRIAN NATIONAL BANK — *Continued*

(Million Schillings)

	Note Circulation	Note Circulation and Sight Liabilities	Gold and Foreign Exchange	Private Discounts
	I	II	III	IV
1934				
I	872	1,082	203	256
II	980	1,108	210	276
III	934	1,112	212	286
IV	915	1,120	214	292
V	893	1,125	278	288
VI	885	1,105	275	241
VII	900	1,117	273	249
VIII	933	1,131	277	253
IX	914	1,138	281	254
X	906	1,133	278	254
XI	888	1,126	282	244
XII	944	1,126	287	238
1935				
I	863	1,120	283	236
II	844	1,118	281	236
III	856	1,112	275	234
IV	873	1,120	279	234
V	869	1,144	294	235
VI	870	1,174	316	235
VII	888	1,178	330	233
VIII	903	1,194	349	233
IX	907	1,220	372	230
X	906	1,219	379	230
XI	893	1,209	372	229
XII	945	1,196	360	228
1936				
I	876	1,190	352	225
II	865	1,157	317	223
III	878	1,161	323	219
IV	883	1,160	323	219
V	897	1,160	324	218
VI	885	1,174	331	220
VII	886	1,173	330	221
VIII	897	1,197	358	219
IX	880	1,214	376	216
X	891	1,170	359	213
XI	861	1,161	348	209
XII	897	1,155	344	208

AUSTRIAN NATIONAL BANK — *Continued*
 (Million Schillings)

	Note Circulation	Note Circulation and Sight Liabilities	Gold and Foreign Exchange	Private Discounts
	I	II	III	IV
1937				
I	846	1,143	341	206
II	826	1,135	349	202
III	841	1,134	341	199
IV	834	1,134	338	197
V	846	1,132	339	195
VI	823	1,140	341	191
VII	840	1,151	348	194
VIII	865	1,172	367	195
IX	855	1,187	383	192
X	861	1,196	394	190
XI	854	1,197	396	186
XII	894	1,205	401	187
1938				
I	846	1,201	404	189
II	827	1,216	416	187

AUSTRIAN INDEX OF INDUSTRIAL PRODUCTION
(1929=100)

1929		1932		1935	
I	102	I	65	I	74
II	98	II	68	II	75
III	99	III	64	III	76
IV	102	IV	65	IV	77
V	99	V	57	V	78
VI	104	VI	59	VI	79
VII	98	VII	56	VII	81
VIII	104	VIII	59	VIII	82
IX	102	IX	56	IX	83
X	102	X	60	X	84
XI	97	XI	58	XI	84
XII	92	XII	57	XII	85
1930		1933		1936	
I	94	I	58	I	85
II	92	II	59	II	85
III	92	III	59	III	85
IV	93	IV	60	IV	85
V	93	V	61	V	85
VI	80	VI	62	VI	85
VII	80	VII	64	VII	85
VIII	79	VIII	65	VIII	86
IX	80	IX	65	IX	87
X	80	X	66	X	88
XI	77	XI	67	XI	89
XII	78	XII	68	XII	92
1931		1934		1937	
I	76	I	68	I	94
II	75	II	69	II	97
III	74	III	69	III	99
IV	79	IV	69	IV	102
V	72	V	70	V	104
VI	69	VI	70	VI	112
VII	75	VII	70	VII	113
VIII	71	VIII	71	VIII	112
IX	75	IX	71	IX	115
X	75	X	72	X	112
XI	76	XI	73	XI	108
XII	75	XII	73	XII	103

AUSTRIAN PRICE INDICES
(1929=100)

	Determined Abroad	Home Determined	Bound Prices	Sensitive Prices
1929				
I	103	103	100	101
II	104	102	101	100
III	107	100	101	101
IV	104	101	101	102
V	100	99	102	97
VI	99	100	102	99
VII	99	100	101	97
VIII	99	100	100	99
IX	100	101	100	102
X	97	101	99	102
XI	92	99	98	101
XII	91	99	98	100
1930				
I	90	99	100	99
II	88	97	99	96
III	83	97	98	94
IV	85	95	98	99
V	81	94	96	88
VI	79	93	96	88
VII	76	93	96	83
VIII	72	93	97	83
IX	70	93	98	82
X	67	91	96	76
XI	65	90	94	72
XII	65	87	94	69
1931				
I	61	85	91	64
II	61	84	92	62
III	62	83	92	63
IV	60	83	91	63
V	59	82	91	59
VI	58	79	92	55
VII	58	79	91	57
VIII	58	77	92	56
IX	56	76	90	53
X	60	76	94	54
XI	64	79	95	59
XII	64	79	95	58

AUSTRIAN PRICE INDICES — *Continued*
(1929=100)

	Determined Abroad	Home Determined	Bound Prices	Sensitive Prices
1932				
I	62	77	104	54
II	60	75	103	53
III	60	73	104	51
IV	58	72	104	48
V	56	70	104	46
VI	52	69	104	46
VII	53	69	103	46
VIII	57	70	102	47
IX	60	71	103	50
X	59	72	104	51
XI	57	70	104	48
XII	57	70	103	48
1933				
I	56	71	103	50
II	56	71	103	48
III	56	71	104	49
IV	57	72	104	50
V	63	73	104	51
VI	66	76	103	57
VII	65	78	105	58
VIII	64	79	102	59
IX	61	78	103	58
X	61	77	105	58
XI	62	76	104	58
XII	62	76	104	59
1934				
I	65	76	105	60
II	66	76	105	60
III	65	77	106	60
IV	65	77	104	60
V	64	76	103	59
VI	63	76	104	59
VII	62	75	103	58
VIII	63	75	104	58
IX	58	77	104	56
X	59	75	104	54
XI	59	75	104	53
XII	60	75	104	54

AUSTRIAN PRICE INDICES — *Continued*
 (1929=100)

	Determined Abroad	Home Determined	Bound Prices	Sensitive Prices
1935				
I	62	75	104	55
II	60	75	105	55
III	59	75	105	53
IV	62	75	105	54
V	64	76	105	56
VI	64	76	105	56
VII	64	76	104	57
VIII	65	76	104	57
IX	64	78	104	58
X	68	79	105	62
XI	68	78	105	61
XII	68	78	105	61
1936				
I	67	79	105	61
II	67	79	105	61
III	68	79	105	62
IV	68	78	105	62
V	68	78	104	62
VI	66	78	104	60
VII	68	78	104	61
VIII	67	79	104	62
IX	67	80	104	62
X	68	81	104	65
XI	74	81	105	66
XII	78	82	105	71
1937				
I	82	82	105	76
II	84	84	105	79
III	91	84	106	84
IV	90	88	106	85
V	85	89	106	84
VI	82	89	106	78
VII	81	88	105	79
VIII	83	89	105	82
IX	79	90	105	79
X	75	89	105	75
XI	71	88	105	71
XII	69	85	104	67
1938				
I	69	87	105	68
II	68	86	105	65

	AGRICULTURAL PRICES (1923-31=100)		INDUSTRIAL PRICES	
	Austrian	Foreign	Austrian	Foreign
1929				
I	98	102	100	99
II	103	103	99	99
III	107	107	99	98
IV	106	100	98	97
V	106	95	97	95
VI	100	93	98	95
VII	107	101	98	96
VIII	103	96	99	99
IX	97	102	103	100
X	94	99	104	100
XI	93	97	101	97
XII	91	98	101	97
1930				
I	93	96	104	97
II	91	93	102	96
III	91	89	100	93
IV	87	86	99	92
V	86	83	99	91
VI	87	81	99	91
VII	85	97	95	87
VIII	93	99	96	85
IX	87	80	95	83
X	83	77	93	80
XI	83	73	92	77
XII	81	72	89	76
1931				
I	79	69	87	74
II	81	69	86	71
III	83	69	86	71
IV	87	72	87	70
V	86	70	82	67
VI	84	73	79	64
VII	91	82	80	66
VIII	90	66	78	68
IX	87	64	76	66
X	90	66	76	65
XI	95	67	80	69
XII	94	65	79	66

AGRICULTURAL PRICES INDUSTRIAL PRICES

(Continued)

(1923-31=100)

	Austrian	Foreign	Austrian	Foreign
1932				
I	93	62	79	65
II	93	63	78	63
III	94	64	75	61
IV	94	63	73	58
V	96	59	72	57
VI	112	58	71	56
VII	101	59	72	55
VIII	93	61	73	58
IX	89	57	75	61
X	90	54	76	60
XI	91	55	73	61
XII	88	53	73	59
1933				
I	85	53	73	57
II	84	52	73	58
III	86	52	73	58
IV	86	53	73	60
V	85	56	73	64
VI	98	58	77	67
VII	93	63	78	71
VIII	82	61	78	71
IX	82	59	78	69
X	82	55	78	69
XI	82	57	77	68
XII	83	57	77	69
1934				
I	80	47	78	59
II	81	46	78	58
III	83	44	78	59
IV	81	43	77	58
V	81	44	76	58
VI	80	45	76	58
VII	81	48	75	58
VIII	84	57	76	58
IX	85	56	77	56
X	85	55	74	56
XI	84	56	75	57
XII	85	59	75	58

	AGRICULTURAL PRICES (Continued) (1923-31 = 100)		INDUSTRIAL PRICES	
	Austrian	Foreign	Austrian	Foreign
1935				
I	84	58	75	58
II	84	57	76	57
III	84	54	75	57
IV	82	55	75	57
V	83	55	76	58
VI	84	53	76	59
VII	84	52	76	60
VIII	86	55	76	60
IX	87	58	77	61
X	89	59	80	62
XI	87	56	80	63
XII	85	53	78	63
1936				
I	84	52	79	63
II	82	53	79	64
III	82	52	78	63
IV	83	53	78	64
V	84	50	78	63
VI	85	50	78	63
VII	86	57	78	63
VIII	88	62	80	64
IX	89	61	80	65
X	90	61	82	64
XI	90	61	82	65
XII	91		84	
1937				
I	90		85	

AUSTRIAN EXPORTS AND IMPORTS BY VALUE
(1929=100)

	Index of Imports (Raw Mate- rials)	Index of Exports (All Prod- ucts)		Index of Imports (Raw Mate- rials)	Index of Exports (All Prod- ucts)		Index of Imports (Raw Mate- rials)	Index of Exports (All Prod- ucts)
1929			1932				1935	
I	94	99	I	57	45	I	37	39
II	93	96	II	50	41	II	35	40
III	94	95	III	45	36	III	36	45
IV	104	105	IV	50	37	IV	38	42
V	103	104	V	48	37	V	36	41
VI	106	109	VI	49	36	VI	35	36
VII	96	108	VII	41	35	VII	38	40
VIII	99	100	VIII	38	32	VIII	34	40
IX	111	100	IX	37	32	IX	37	39
X	100	97	X	34	34	X	43	42
XI	96	97	XI	39	36	XI	41	43
XII	100	93	XII	36	32	XII	38	44
1930			1933				1936	
I	77	96	I	37	33	I	41	44
II	76	100	II	33	33	II	39	41
III	78	91	III	38	34	III	43	48
IV	79	95	IV	32	33	IV	39	45
V	84	88	V	36	38	V	37	44
VI	79	85	VI	37	36	VI	34	41
VII	76	82	VII	41	42	VII	36	40
VIII	79	81	VIII	33	38	VIII	38	42
IX	76	81	IX	34	40	IX	38	43
X	76	83	X	39	40	X	41	43
XI	73	77	XI	41	41	XI	41	44
XII	67	75	XII	36	36	XII	41	46
1931			1934				1937	
I	67	69	I	37	38	I	41	46
II	71	68	II	35	39	II	44	51
III	63	64	III	39	44	III	48	57
IV	71	68	IV	37	39	IV	46	55
V	71	68	V	38	38	V	46	55
VI	60	64	VI	36	40	VI	47	57
VII	61	65	VII	33	38	VII	45	61
VIII	54	59	VIII	32	40	VIII	42	55
IX	59	60	IX	35	39	IX	43	55
X	60	57	X	38	40	X	46	57
XI	62	55	XI	38	41	XI	43	56
XII	58	53	XII	34	38	XII	46	59
						1938		
						I	41	45

BANKNOTE CIRCULATION IN AUSTRIA*

(Number of Banknotes in Millions)

Denomination	1928	1929	1930	1931	1932
1,000 Schillings	103 185	113 615	104 791	226 800	26 600
100 Schillings	5,623 720	5,308 640	5,334 294	5,367 453	5,099 392
50 Schillings		2,212 225	2,345 565	2,164 085	1,807 089
20 Schillings	11,986 789	9,280 059	8,901 878	8,368 269	7,418 945
10 Schillings	11,661 288	11,097 991	11,255 479	10,255 690	9,876 497
5 Schillings	8,371 966	8,524 837	8,782 670	8,365 589	7,930 365

* In Fig. 2, p. 32 the curves represent total values, not numbers of notes, in each denomination.

AUSTRIA

GOLD PRICES IN PER CENT OF PARITY

	1931	1932	1933
I	129	122	
II	136	121	
III	129	126	
IV	115	129	
V	125	131	
VI	133	127	
VII	129	128	
VIII	121	128	
IX	100	120	128
X	122	120	128
XI	130	120	
XII	140	120	

Source of statistics, pp. 74-85 Monatsberichte des Österreichischen Institutes für Konjunkturforschung

NATIONAL BANK OF HUNGARY
Monetary Series¹

Date	Reserves in Gold and Devisen In 1 000 Pengo	Bills Discounted In 1 000 Pengo	Notes Fractional Money and Deposits (Seasonally Adjusted) In 1 000 Pengo		Demand Deposits of the State In 1 000 Pengo
1931					
I	164,475	265,060	510,664		
II	136,391	279,726	495,294	8,948	
III	115,832	353,501	590,005	32,371	
IV	125,160	401,869	588,081	30,311	
1932					
I	123,249	418,904	555,328	30,731	
II	118,890	432,035	536,043	23,157	
III	117,962	415,290	517,881	58,538	
IV	120,592	421,988	486,975	41,678	
1933					
I	120,410	468,901	487,212	59,070	
II	121,017	476,475	504,281	35,608	
III	101,617	437,496	504,398	49,413	
IV	90,877	569,527	501,240	64,534	
1934					
I	93,440	588,221	511,387	49,035	
II	90,273	570,030	500,719	29,478	
III	93,125	533,908	493,686	47,750	
IV	99,279	565,164	511,220	71,612	
1935					
I	98,825	538,040	516,034	64,995	
II	99,844	525,241	542,290	70,682	
III	94,174	491,952	545,097	75,028	
IV	112,287	523,648	581,581	104,550	
1936					
I	111,858	516,461	585,964	96,576	
II	105,310	499,899	597,324	98,437	
III	110,134	470,144	617,121	129,689	
IV	126,414	487,757	656,103	169,657	
1937					
I	131,480	463,745	693,785	178,980	
II	137,906	400,366	710,543	148,249	
III	141,779	384,213	723,239	174,590	
IV	142,592	409,930	722,759	203,026	
1938					
I	149,947	469,942	785,383	207,968	
II	155,930	439,212	904,809	163,195	
III	219,086	520,457	941,347	122,077	
IV	220,598	466,163	1,050,369	141,243	
1939					
I	211,429	481,057	1,147,617	141,264	

¹ Data for all series, unless otherwise noted, from Quarterly Reports, U I f W For columns 1, 2 and 4, quarterly figures as of March 31, June 30, September 30, and December 31

² Quarterly averages Data for notes and fractional money are unadjusted figures published by the Hungarian Institute for Economic Research, data for deposits from the London Economist Seasonal adjustment has been carried through here *de novo*

INDEX OF INDUSTRIAL PRODUCTION IN HUNGARY

Seasonally Adjusted¹

Quarterly Averages

(1929 = 100)

		1935	
1931	I	86 9	I
	II	90 0	II
	III	85 7	III
	IV	87 3	IV
1932		1936	
	I	89 5	I
	II	75 6	II
	III	78 4	III
	IV	83 5	IV
1933		1937	
	I	85 4	I
	II	85 4	II
	III	90 4	III
	IV	91 3	IV
1934		1938	
	I	93 6	I
	II	103 6	II
	III	99 3	III
	IV	100 4	IV
		1939	
		I	147 0

BUDGET BALANCES OF HUNGARY

Including State Undertakings

In Million Pengo²

1930-31	-229 5	1935-36	-34 6
1931-32	-179 7	1936-37	+ 8 1
1932-33	-108 5	1937-38	-67 9
1933-34	- 66 3	1938-39	- 1
1934-35	- 70 4		(estimated)

DISCOUNT RATE OF THE HUNGARIAN NATIONAL BANK³

Per Cent

Per Cent

May 30, 1930 to June 15, 1931, 5½	April 18, 1932 to June 30, 1932, 6
June 16, 1931 to July 23, 1931, 7	July 1, 1932 to Oct 17, 1932, 5
July 24, 1931 to Sept 10, 1931, 9	Oct 18, 1932 to Aug 28, 1935, 4½
Sept 11, 1931 to Jan 19, 1932, 8	Aug 29, 1935 — 4
Jan 20, 1932 to April 17, 1932, 7	

1 Data are quarterly unadjusted indices of industrial production of the Hungarian Institute for Economic Research, seasonal adjustment has been carried through here *de novo*.

2 Ung Wirt Jhrb, Vol 14, p 297

3 Quarterly Reports, U I f W

HUNGARIAN PRICE INDICES¹

(Base 1925-1927)

		WHOLESALE PRICE INDICES				Cost of Living Index Hungarian Stat Office	Wholesale Prices in England (Base 1925-27) Board of Trade Index Revised to Gold Basis
		Sensitive Prices	General Wholesale	Agricultural Products	Industrial and Half finished		
1931	I	91 3	74 8	69 0	88 9	92 1	68 2
	II	91 0	75 6	69 4	89 3	92 3	67 8
	III	91 3	75 6	70 5	88 4	93 5	67 3
	IV	90 5	74 1	69 4	87 5	93 0	67 5
	V	81 7	72 7	68 9	85 3	93 5	66 6
	VI	75 4	72 2	68 1	85 6	93 3	65 8
	VII	78 4	72 2	69 2	85 2	94 8	64 9
	VIII	76 9	70 9	66 1	85 0	95 4	63 0
	IX	81 2	71 7	66 6	85 3	96 0	58 9
	X	84 7	72 8	67 0	86 4	95 0	51 6
	XI	87 1	75 4	70 2	89 2	93 6	50 1
	XII	85 2	75 0	68 1	90 9	93 2	44 3
1932	I	82 9	73 0	66 3	89 0	92 2	45 2
	II	82 9	72 9	66 0	88 6	91 0	45 4
	III	79 7	71 9	65 1	86 8	91 0	48 8
	IV	79 2	69 5	62 4	85 8	90 7	48 3
	V	77 5	68 7	62 0	84 5	92 4	46 3
	VI	75 1	66 9	61 2	83 7	92 2	44 5
	VII	73 9	65 4	58 4	83 1	91 6	42 8
	VIII	76 0	64 8	56 6	83 4	92 4	42 7
	IX	77 3	65 2	57 5	83 3	92 1	44 2
	X	76 6	64 4	56 3	83 0	91 5	42 0
	XI	77 3	63 1	55 0	82 2	89 6	40 5
	XII	77 1	61 7	53 0	81 8	88 4	40 5
1933	I	76 4	61 3	53 2	77 7	88 2	41 4
	II	75 7	61 7	53 6	78 9	87 2	41 4
	III	76 3	61 6	53 5	78 7	86 8	41 1
	IV	76 7	60 6	51 2	78 5	86 5	40 9
	V	79 0	60 7	50 3	79 8	86 0	40 7
	VI	72 4	61 7	51 0	80 4	85 9	41 7
	VII	72 4	61 3	50 0	81 7	83 5	42 3
	VIII	72 9	59 4	47 6	79 5	83 5	41 4
	IX	78 6	58 6	46 6	79 2	83 2	39 5
	X	78 6	58 7	46 5	79 5	81 4	39 2
	XI	77 7	58 7	46 8	78 6	80 8	40 7
	XII	78 1	59 7	48 0	78 6	81 9	41 2

¹ All indices from U I f K , Vol 1-42

HUNGARIAN PRICE INDICES — *Continued*
 (Base 1925-1927)

		Sensitive Prices	WHOLESALE PRICE INDICES			Cost of Living Index Hungarian Stat Office	Wholesale Prices in England (Base 1925-27) Board of Trade Index Revised to Gold Basis
			General Wholesale Products	Agricultural Products	Industrial and Half finished		
1934	I	78 2	60 0	48 5	78 3	82 0	40 8
	II	78 2	62 5	50 9	78 6	82 6	39 2
	III	77 8	62 0	51 1	77 9	82 4	38 6
	IV	75 2	61 1	50 0	77 4	82 6	38 6
	V	73 0	64 2	55 1	77 3	84 6	38 5
	VI	75 0	63 2	53 8	77 2	84 3	38 2
	VII	74 4	62 5	52 7	76 3	83 2	38 7
	VIII	75 2	64 1	54 8	76 2	83 5	39 0
	IX	78 2	64 9	56 1	76 3	83 3	37 6
	X	77 4	65 2	56 7	76 4	83 2	37 6
	XI	78 9	65 7	57 4	76 6	82 4	37 5
	XII	77 8	65 5	57 5	76 1	82 3	37 7
1935	I	78 4	66 1	59 4	75 4	82 3	37 9
	II	77 2	67 4	60 5	75 4	82 8	37 5
	III	78 9	66 5	59 5	74 6	83 4	36 5
	IV	77 5	66 7	58 8	74 2	83 3	37 4
	V	77 2	66 5	58 4	73 7	83 4	38 9
	VI	71 9	67 1	58 7	75 7	84 1	38 8
	VII	74 0	70 2	63 0	77 7	86 5	38 9
	VIII	73 5	70 8	64 3	77 5	87 2	38 9
	IX	74 4	72 8	65 9	79 0	86 9	40 0
	X	76 6	76 0	70 2	80 1	86 7	40 7
	XI	76 4	76 8	71 6	80 4	86 5	40 7
	XII	80 4	77 5	72 5	81 0	87 0	40 8
1936	I	81 3	76 3	70 3	81 8	88 6	40 8
	II	81 6	76 8	71 0	81 9	89 1	40 6
	III	81 6	76 4	70 0	82 3	89 3	40 6
	IV	79 0	75 0	67 6	82 2	89 9	40 6
	V	76 5	73 7	65 9	82 1	89 8	40 3
	VI	76 3	72 2	63 9	82 2	89 0	40 8
	VII	77 8	73 0	64 6	82 4	88 7	42 0
	VIII	78 7	73 6	65 8	82 4	90 3	42 4
	IX	81 6	74 4	67 0	82 9	90 5	42 7
	X	90 7	77 6	71 6	83 7	90 9	42 2
	XI	90 3	78 6	72 3	84 6	90 1	42 9
	XII	91 2	80 7	74 8	85 2	91 1	44 9

HUNGARIAN PRICE INDICES—*Continued*
 (Base 1925-1927)

		WHOLESALE PRICE INDICES			Cost of Living Index Hungarian Stat. Office	Wholesale Prices in London (base 1925-27) Board of Trade Index Revised to Gold Basis	
	Seasonal Prices	General Wholesale	Agricultural Products	Industrial and Half-finished			
1937	I	91.7	84.0	78.0	87.6	94.6	45.9
	II	90.9	84.5	76.8	88.1	95.3	46.4
	III	92.6	85.4	77.7	87.7	95.2	49.1
	IV	92.6	83.6	74.7	91.3	94.9	48.6
	V	89.1	83.4	74.3	91.2	94.8	49.1
	VI	87.5	82.2	74.0	89.9	95.0	47.9
	VII	87.2	83.2	76.2	89.3	95.2	48.5
	VIII	87.3	82.8	75.9	89.0	95.4	47.8
	IX	88.0	81.8	75.5	87.7	96.5	46.5
	X	87.2	81.2	75.2	86.8	96.5	45.5
	XI	85.5	80.1	74.2	86.9	96.2	44.3
	XII	85.1	79.4	74.1	86.7	96.8	44.4
1938	I	85.3	78.9	73.4	86.8	97.6	44.0
	II	84.4	78.3	71.9	86.7	96.7	43.7
	III	84.6	77.8	71.2	86.2	96.8	42.6
	IV	83.5	78.2	72.2	85.7	97.5	42.1
	V	80.3	76.2	70.6	84.8	97.5	41.7
	VI	74.1	75.9	69.9	84.1	95.8	41.7
	VII	73.0	75.8	69.0	84.0	94.8	40.9
	VIII	73.5	76.3	70.4	84.4	94.8	39.5
	IX	76.1	77.9	72.0	84.7	96.1	38.8
	X	76.6	78.0	71.9	84.2	95.7	38.5
	XI	78.6	77.3	70.9	84.2	95.5	37.4
	XII	78.8	76.3	69.2	84.1	95.2	36.9
1939	I	77.4	76.3	69.9	83.0	94.6	37.0

INDICES OF THE FOREIGN VALUE OF PENGÖ

Date	Pengö Note Quotations in Zurich as Per Cent of Parity ¹	Gold Price in Budapest as Per Cent of Parity ²
1931		
VII		111
VIII		126
IX		132
X		147
XI		144
XII		170
1932		
I		147
II		144
III		147
IV		137
V	760	147
VI	732	147
VII	736	137
VIII	751	132
IX	771	126
X	784	126
XI	814	118
XII	809	126
1933		
I	791	137
II	743	137
III	734	132
IV	745	137
V	745	137
VI	752	132
VII	730	140
VIII	759	132
IX	710	137
X	738	137
XI	754	137
XII	766	132

¹ Percentages computed from prices in Swiss francs as given by the Schweizerische Nationalbank in its Monatsberichte, and by Zürcher Nachrichten, monthly averages

² Percentages of par computed from pengo prices of one kilogram gold as given in various daily newspapers in Budapest, median between daily high and low quotation, middle of month

INDICES OF THE FOREIGN VALUE OF PENGÓ—*Continued*

Date	Pengo Note Quotations in Zurich as Per Cent of Parity	Gold Price in Budapest as Per Cent of Parity
1934		
I	757	132
II	749	137
III	712	142
IV	707	142
V	703	142
VI	682	145
VII	682	147
VIII	682	145
IX	694	145
X	685	145
XI	666	150
XII	647	153
1935		
I	644	153
II	615	162
III	628	158
IV	615	
V	609	
VI	628	
VII	639	
VIII	653	
IX	652	
X	637	
XI	621	
XII	613	
1936		
I	625	
II	649	
III	650	
IV	649	
V	659	
VI	668	
VII	649	
VIII	659	
IX	667	
X	603	
XI	609	
XII	613	

INDICES OF THE FOREIGN VALUE OF PENGÓ—*Continued*

Date	Pengo Note Quotations in Zurich as Per Cent of Parity	Gold Price in Budapest as Per Cent of Parity
1937		
I	616	
II	611	
III	617	
IV	641	
V	667	
VI	667	
VII	643	
VIII	636	
IX	623	
X	644	
XI	630	
XII	632	
1938		
I	622	
II	625	
III	608	
IV	530	
V	514	
VI	540	
VII	549	
VIII	527	
IX	464	
X	517	
XI	498	
XII	384	
1939		
I	284	
II	327	
III	318	

VALUE OF HUNGARIAN IMPORTS AND EXPORTS BY QUARTERS¹
 (in Million Pengo)

		Imports	Exports		Imports	Exports
1929	I	247 3	183 3	1934	I	74 6
	II	296 7	214 4		II	88 8
	III	262 1	280 7		III	83 7
	IV	257 6	360 1		IV	97 8
<hr/>		<hr/>	<hr/>	<hr/>		<hr/>
1929		1,063 7	1,038 5	1934		344 9
						404 2
1930	I	198 0	218 4	1935	I	84 0
	II	210 9	233 4		II	89 3
	III	218 9	213 0		III	94 0
	IV	195 5	246 9		IV	135 0
<hr/>		<hr/>	<hr/>	<hr/>		<hr/>
1930		823 4	911 7	1935		402 3
						451 5
1931	I	142 2	130 4	1936	I	106 6
	II	163 7	126 5		II	114 7
	III	125 5	142 3		III	103 1
	IV	108 0	171 2		IV	112 1
<hr/>		<hr/>	<hr/>	<hr/>		<hr/>
1931		539 4	570 4	1936		436 5
						504 4
1932	I	85 0	72 2	1937	I	99 9
	II	84 2	79 4		II	122 7
	III	75 2	81 4		III	127 9
	IV	84 1	101 5		IV	133 1
<hr/>		<hr/>	<hr/>	<hr/>		<hr/>
1932		328 5	334 5	1937		483 6
						588 0
1933	I	70 1	78 6	1938	I	95 8
	II	74 1	80 7		II	104 5
	III	78 3	109 0		III	98 2
	IV	90 1	123 0		IV	120 0
<hr/>		<hr/>	<hr/>	<hr/>		<hr/>
1933		312 6	391 3	1938		418 5
						522 6
				1939 I		122 1
						142 5

1 U I f K , Vol 36, p 52, Vol 41, p 67, and Vol 42, p 67

THE PURCHASING POWER OF HUNGARIAN AGRICULTURE¹
(1924-25 to 1926-27 = 100)

1924-25	94	1932-33	48
1925-26	103	1933-34	47
1926-27	103	1934-35	49
1927-28	105	1935-36	54
1928-29	109	1936-37	65
1929-30	106	1937-38	69
1930-31	79	1938-39	83 (estimated)
1931-32	58	1939 (I III)	74

HARVEST OF THE MOST IMPORTANT AGRICULTURAL
PRODUCTS IN HUNGARY²

Year	Wheat	Rye	Barley	Oats	Corn	Potatoes	Sugar
							Beets
				Million Quintals			
1925	19.5	8.3	5.5	3.7	22.4	23.6	15.3
1926	20.4	8.0	5.6	3.6	19.5	19.2	14.5
1927	20.9	5.7	5.2	3.3	17.4	20.6	14.6
1928	27.0	8.3	6.7	4.0	12.6	14.7	14.4
1929	20.4	8.0	6.8	4.1	17.9	21.7	16.1
1930	23.0	7.2	6.0	2.6	14.1	18.4	14.6
1931	19.8	5.5	4.8	1.9	15.2	14.5	9.7
1932	17.5	7.7	7.2	3.2	24.3	15.6	8.5
1933	26.2	9.6	8.4	3.6	18.1	18.6	9.4
1934	17.6	6.2	5.4	2.6	21.0	21.2	9.2
1935	22.9	7.3	5.6	2.5	14.2	13.9	7.7
1936	23.9	7.1	6.6	2.6	25.9	24.5	11.2
1937	19.6	6.2	5.6	2.7	27.6	25.6	10.1
1938	26.9	8.0	7.2	3.1	26.6	21.4	9.7

1 U I f W, Vol 41, p 79, and Vol 42, p 78, seasonally adjusted

2 U I f W, Vol 42, p 78

HUNGARY'S EXPORT AND IMPORT TRADE WITH HER CHIEF
CREDITOR COUNTRIES¹

	In Million Pengo									
Exports	1930	1931	1932	1933	1934	1935	1936	1937	1938	
France	16 2	26 2	14 6	17 6	13 9	10 7	9 6	12 3	10 1	
United States	3 9	4 0	2 7	5 9	5 2	8 8	13 3	17 2	12 8	
England	51 5	55 9	22 2	31 3	31 5	36 8	44 0	42 0	41 5	
Switzerland	36 9	37 6	15 8	20 3	19 7	18 5	30 0	24 9	16 8	
Total in Pengo	108 5	123 7	55 3	75 1	70 3	74 8	96 9	96 4	81 2	
Total as per cent of all Exports	12 0	21 7	17 2	19 2	16 0	16 6	19 2	16 4	15 6	
Imports										
France	23 3	17 7	13 5	17 4	10 3	4 5	4 6	4 3	6 2	
United States	39 6	23 1	14 1	20 6	19 7	19 6	23 2	21 4	25 1	
England	34 2	20 9	15 0	13 6	18 0	20 2	22 2	25 0	21 4	
Switzerland	18 8	13 4	11 7	5 5	8 0	12 4	10 2	11 1	10 4	
Total in Pengo	115 9	75 1	54 3	57 1	56 0	56 7	60 2	61 8	63 1	
Total as per cent of all Imports	14 1	14 0	16 3	18 4	16 5	14 7	13 7	12 9	14 3	

THE BALANCE OF HUNGARIAN TRADE WITH HER
PRINCIPAL CREDITORS¹

	1930	1931	1932	1933	1934	1935	1936	1937	1938
France	- 7 1	+ 8 5	+ 1 1	+ 2	+ 3 6	+ 6 2	+ 5 0	+ 8 0	+ 3 9
United States	- 35 7	- 19 1	- 11 4	- 14 7	- 14 5	- 10 8	- 9 9	- 4 2	- 12 3
England	+ 17 3	+ 35 0	+ 7 2	+ 17 7	+ 13 5	+ 16 6	+ 21 8	+ 17 0	+ 20 1
Switzer- land	+ 18 1	+ 24 2	+ 4 1	+ 14 8	+ 11 7	+ 6 1	+ 19 8	+ 13 8	+ 6 4
Total	- 7 4	+ 48 6	+ 1 0	+ 18 0	+ 14 3	+ 18 1	+ 36 7	+ 34 6	+ 18 1

1 Computed from trade statistics in *Statisztikai Havi Kozlemenek*
(Royal Hungarian Statistical Office, Budapest), Vol 35-41

THE HUNGARIAN "FOREIGN CREDITORS' FUND" OR "CASH OFFICE OF FOREIGN CREDITS"¹

(In million Pengo)

Dates	Receipts in Cash and Treasury Bills	Receipts in Treasury Bills	Loans to State and to State Railways			Cash on Hand Amounts
			Disbursements Cumulative Figures	Arrears to the Fund	Loans to State and to State Railways	
Jan 1, 1932 to June 30	58 32		10 70	8 26		48 14
July 1 to Sept 30	76 11		23 78	26 37		52 85
Oct 1 to Nov 30	89 00		27 60	30 30		61 92
Dec 1, 1932 to March 31, 1933	110 30		42 20	49 10		66 40
April 1 to June 30	123 45		59 71	55 79 ²		52 80
July 1 to Sept 30	167 40		75 60	25 47 ³	19 50	47 30
Oct 1 to Nov 30	174 80		25 60	80 90	27 75 ³	18 50
Dec 1, 1933 to March 31, 1934	202 60		43 30	103 10	22 06 ³	16 50
April 1 to June 30	216 60		46 20	110 90	20 94 ³	22 60
July 1 to Sept 30	230 20		51 30	122 80	23 00	36 30
Oct 1 to Nov 30	240 50		53 70	127 10	23 81	22 00
Dec 1, 1934 to March 31, 1935	247 40		61 40	134 20	27 00	25 00
April 1 to April 30	259 40		62 40	142 40	28 80	46 00
May 1 to Sept 30	274 30		67 60	154 60	31 60	46 00
Oct 1 to Dec 31, 1935	291 20		71 80	164 90	31 30	46 00
Jan 1, 1936 to March 31	299 30		76 20	177 10	35 50	45 50
April 1 to June 30	315 80		80 30	181 90	20 50	57 00
July 1 to Sept 30	331 30		85 00	194 80	17 00	56 50
Oct 1 to Dec 31, 1936	342 40		87 60	205 70	15 00	56 50
Jan 1, 1937 to March 31, 1937	356 50		91 10	214 70	5 40	55 50
April 1 to June 30	363 60		93 70	219 50	5 90	55 50
July 1 to July 16	378 60		97 10	223 40	54 50	30 20
July 17 to Dec 31, 1937	378 50		97 10	223 00	54 50	30 20

¹ Compiled from Tyler, Quarterly Reports, not all items of the statement are included² Not taking account of devaluation³ Taking account of pound and dollar devaluation

REICHSBANK¹
Monthly Averages
(In million Reichsmarks)

Months	Notes in Circulation	Demand Deposits	Gold and Devisen Reserves	Bills Discounted	Reserves as Per Cent of Notes in Circulation
<i>1929</i>					
I	4,206 9	608 8	2,886 6	1,772 4	68 6
II	4,192 1	516 7	2,836 5	1,633 5	67 6
III	4,339 6	489 5	2,739 5	1,884 1	63 1
IV	4,285 6	673 3	2,319 1	2,433 1	54 1
V	4,305 6	625 9	1,903 7	2,796 1	44 2
VI	4,367 9	611 3	2,130 7	2,742 9	48 8
VII	4,443 5	571 4	2,415 0	2,508 8	54 3
VIII	4,453 6	455 5	2,478 2	2,335 4	55 6
IX	4,532 6	479 8	2,519 6	2,384 5	55 6
X	4,495 0	476 4	2,571 6	2,283 1	61 6
XI	4,493 9	499 3	2,615 6	2,187 8	58 2
XII	4,723 9	511 1	2,659 6	2,357 4	56 3
<i>1930</i>					
I	4,349 4	548 4	2,687 4	2,036 8	61 8
II	4,318 6	509 4	2,777 4	1,816 3	64 3
III	4,415 2	509 6	2,895 3	1,786 2	65 6
IV	4,412 5	606 7	2,901 8	1,869 9	65 8
V	4,364 6	559 7	2,910 4	1,730 8	66 7
VI	4,393 7	531 6	3,048 4	1,622 5	69 4
VII	4,320 6	468 1	2,881 0	1,588 8	66 7
VIII	4,346 2	471 3	2,957 4	1,520 9	68 0
IX	4,377 3	409 6	2,851 8	1,598 3	65 1
X	4,336 4	376 4	2,413 8	2,092 1	55 7
XI	4,264 8	344 8	2,614 9	1,890 9	61 3
XII	4,937 3	437 2	2,732 6	2,119 4	61 6
<i>1931</i>					
I	4,106 9	366 7	2,495 9	1,867 4	60 8
II	4,028 5	311 8	2,442 4	1,753 8	60 6
III	4,083 5	324 4	2,497 6	1,770 6	61 2
IV	4,068 9	363 6	2,493 4	1,722 9	62 0
V	4,009 3	335 0	2,555 9	1,592 9	63 7
VI	3,997 1	356 3	1,876 8	2,199 7	46 9
VII	4,230 1	517 2	1,601 3	2,975 0	37 9
VIII	4,261 6	586 8	1,689 2	3,193 5	39 6
IX	4,331 2	495 3	1,652 7	3,146 3	38 2
X	4,542 1	513 7	1,304 4	3,808 7	28 7
XI	4,478 2	434 1	1,200 7	3,805 9	26 8
XII	4,604 4	502 9	1,161 8	3,933 5	25 2

¹ Economist (London)

REICHSBANK¹—(Continued)

Monthly Averages

(In million Reichsmarks)

Months	Notes in Circulation	Demand Deposits	Gold and Devisen Reserves	Bills Discounted	Reserves as Per Cent of Notes in Circulation
1932					
I	4,390 5	391 5	1,115 7	3,640 1	25 4
II	4,175 7	364 5	1,075 2	3,314 4	25 7
III	4,132 3	433 1	1,023 7	3,285 7	24 8
IV	4,022 3	382 4	996 7	3,067 6	24 8
V	3,903 4	378 0	989 3	2,994 5	25 3
VI	3,851 5	402 7	967 0	2,998 4	25 1
VII	3,840 4	369 7	905 7	3,055 7	23 6
VIII	3,786 0		907 7	2,959 7	24 0
IX	3,636 3	402 6	922 1	2,886 2	25 4
X	3,542 8	386 4	934 4	2,815 5	26 4
XI	3,438 3	392 8	934 8	2,688 5	27 2
XII	3,442 8	408 2	917 9	2,681 9	26 7
1933					
I	3,281 6	356 0	921 2	2,435 1	28 1
II	3,222 3	359 5	920 5	2,366 4	28 6
III	3,319 0	374 1	846 9	2,599 4	25 5
IV	3,417 9	365 2	576 8	2,978 4	16 9
V	3,365 2	382 1	470 2	3,004 5	14 0
VI	3,334 6	412 6	340 4	3,099 2	10 2
VII	3,371 0	381 1	303 4	3,104 4	9 0
VIII	3,369 6	380 1	355 8	3,046 9	10 6
IX	3,434 2	410 2	400 7	3,117 5	11 7
X	3,449 2	404 4	412 0	3,124 6	11 9
XI	3,408 7	446 1	407 8	2,947 4	12 0
XII	3,499 2	482 1	399 6	3,036 8	11 4
1934					
I	3,377 1	496 8	391 9	2,819 9	11 6
II	3,337 4	515 2	341 9	2,730 3	10 2
III	3,427 6	535 7	275 0	2,925 6	8 0
IV	3,462 9	496 6	227 4	2,971 6	6 6
V	3,495 4	506 1	161 9	3,046 1	4 6
VI	3,541 9	534 3	93 6	3,161 9	2 6
VII	3,617 1	608 1	77 7	3,303 2	2 1
VIII	3,641 3	676 1	78 3	3,333 6	2 1
IX	3,714 7	762 5	78 8	3,521 6	2 1
X	3,706 8	837 0	84 6	3,580 7	2 2
XI	3,650 4	923 4	82 4	3,606 8	2 3
XII	3,765 3	841 0	83 2	3,748 2	2 2

¹ Economist (London)

REICHSBANK¹ — (*Continued*)

Monthly Averages
(In million Reichsmarks)

Months	Notes in Circulation	Demand Deposits	Gold and Devisen Reserves	Bills Discounted	Reserves as Per Cent of Notes in Circulation
<i>1935</i>					
I	3,584 2	907 2	83 9	3,530 5	2 3
II	3,475 8	833 3	84 6	3,509 8	2 4
III	3,462 8	911 8	84 9	3,569 1	2 5
IV	3,538 0	917 3	85 4	3,654 8	2 4
V	3,571 7	862 6	86 3	3,605 4	2 4
VI	3,681 1	770 1	88 4	3,646 8	2 4
VII	3,707 7	737 4	98 6	3,614 1	2 6
VIII	3,781 9	753 1	102 5	3,717 5	2 7
IX	3,908 0	752 1	100 2	3,865 5	2 6
X	3,969 4	713 5	94 8	3,991 9	2 4
XI	3,967 5	720 8	93 4	3,875 9	2 4
XII	4,121 7	822 1	89 2	4,098 1	2 2
<i>1936</i>					
I	3,931 7	709 1	83 2	3,778 8	2 1
II	3,925 7	627 7	80 0	3,745 0	2 0
III	4,015 9	655 9	77 2	3,838 5	1 9
IV	4,106 1	721 1	73 5	4,142 1	1 8
V	4,157 8	703 0	76 1	4,281 4	1 8
VI	4,146 5	767 5	76 1	4,330 9	1 8
VII	4,211 8	787 2	77 6	4,428 9	1 8
VIII	4,307 0	692 4	76 5	4,464 2	1 8
IX	4,380 4	702 0	71 0	4,565 7	1 6
X	4,463 9	686 0	69 1	4,660 5	1 5
XI	4,451 2	676 5	70 6	4,609 8	1 6
XII	4,686 3	773 0	71 9	4,909 5	1 5
<i>1937</i>					
I	4,580 6	741 7	72 5	4,680 5	1 6
II	4,541 4	743 3	72 6	4,495 3	1 6
III	4,631 6	794 9	73 1	4,623 2	1 6
IV	4,628 3	790 6	74 0	4,688 4	1 6
V	4,698 5	773 7	74 3	4,811 2	1 6
VI	4,676 7	745 0	74 6	4,789 1	1 6
VII	4,787 1	700 8	74 9	4,945 5	1 6
VIII	4,832 1	659 2	75 5	4,968 7	1 6
IX	4,905 9	701 1	75 8	5,070 9	1 5
X	4,975 0	689 5	75 9	5,179 2	1 5
XI	4,922 7	724 1	76 1	5,150 1	1 5
XII	5,150 8	806 8	76 1	5,493 5	1 5

¹ Economist (London)

REICHSBANK¹— (*Continued*)

Monthly Averages

(In million Reichsmarks)

Months	Notes in Circulation	Demand Deposits	Gold and Devisen Reserves	Bills Discounted	Reserves as Per Cent of Notes in Circulation
<i>1938</i>					
I	4,972 2	788 8	76 3	5,176 8	1 5
II	4,925 0	790 8	76 2	5,126 0	1 5
III	5,116 2	947 3	76 2	5,343 8	1 5
IV	5,592 5	1,204 0	76 2	5,460 9	1 4
V	5,885 2	984 2	76 3	5,431 2	1 3
VI	6,038 6	1,067 2	76 6	5,633 4	1 3
VII	6,224 6	940 8	76 3	5,830 8	1 2
VIII	6,432 9	957 8	76 5	6,082 6	1 2
IX	7,031 4	1,007 7	76 4	6,857 2	1 1
X	7,384 7	937 8	76 6	7,151 2	1 0
XI	7,342 2	1,012 6	76 8	6,980 3	1 0
XII	7,794 9	1,154 9	76 6	7,524 8	1 0
<i>1939</i>					
I	7,528 2	997 3	76 5	6,983 3	1 0
II	7,517 7	1,070 8	76 5	6,834 5	1 0
III	7,771 4	1,063 8	76 6	7,331 2	1 0
IV	8,029 7	1,088 7	76 6	7,470 5	0 9
V	8,145 8	1,168 2	76 8	7,382 9	0 9
VI	8,204 2	1,077 1	76 7	7,582 3	0 9
VII	8,520 7	1,106 2	76 8	8,042 9	0 9
VIII	9,280 0	1,216 8	76 8	8,746 1	0 8

¹ Economist (London)

REICHSBANK RATE OF DISCOUNT¹
1929-1938

1929		Per Cent	1931		Per Cent
January	12, 1929	6½	June	14, 1931	7
April	25, 1929	7½	July	16, 1931	10
November	2, 1929	7	August	1, 1931	15
			August	12, 1931	10
1930			September	2, 1931	8
January	14, 1930	6½	December	10, 1931	7
February	6, 1930	6			
March	8, 1930	5½	1932		
March	25, 1930	5	March	9, 1932	6
May	20, 1930	4½	April	9, 1932	5½
June	21, 1930	4	April	28, 1932	5
October	9, 1930	5	September 22, 1932	4 — to date	

¹ Economist (London)

BANK OF ENGLAND RATE OF DISCOUNT¹

	1929	1930	1931	1932
I	4 50	5 0	3	6
II	5 50	4 5	3	5
III	5 50	3 5	3	3 5
IV	5 50	3 5	3	3
V	5 50	3 0	2 5	2 5
VI	5 50	3	2 5	2
VII	5 50	3	4 5	2
VIII	5 50	3	4 5	2
IX	6 50	3	6 0	2
X	6 00	3	6	2
XI	5 50	3	6	2
XII	5 00	3	6	2

¹ League of Nations Monthly Bulletin of Statistics

BRITISH, FRENCH, AND GERMAN PRICES

(Revised basis 1925-1927 = 100)

	British Wholesale Prices in Gold ¹				German Wholesale Prices			
	I	II	III	IV	I	II	III	IV
1931	67 8	66 6	62 0	48 7	83 0	82 1	79 9	76 7
1932	46 5	46 4	43 2	41 0	72 4	70 6	69 3	67 8
1933	41 3	41 1	41 1	40 4	66 1	66 6	68 4	69 6
1934	39 5	38 4	38 4	37 6	69 8	69 9	72 4	73 3
1935	37 3	38 4	39 3	40 7	73 2	73 2	74 1	74 8
1936	40 7	40 6	42 4	43 4	75 2	75 3	75 7	75 8
1937	47 1	48 5	47 6	44 7	76 6	76 8	77 7	76 6
1938	43 4	41 8	39 7	37 6	76 7	76 6	76 7	77 0
1939					77 3			

	German Sensitive Prices				German Cost of Living ²			
	I	II	III	IV	I	II	III	IV
1931	58 6	53 6	48 4	43 9	96 9	95 4	94 2	91 9
1932	39 7	36 4	38 0	40 9	85 7	83 9	83 2	82 3
1933	41 3	44 3	46 5	44 5	81 0	81 4	82 1	83 4
1934	46 3	43 6	50 6	49 7	83 5	83 3	84 6	84 9
1935	50 3	52 6	53 5	56 6	85 0	86 3	86 2	85 5
1936	57 0	57 4	57 8	59 1	86 5	86 4	86 9	86 4
1937	62 7	61 6	61 1	58 0	86 7	87 0	87 4	86 7
1938	57 2	56 3	56 8	57 6	87 0	87 4	87 7	86 9
1939					87 4			

	French Wholesale Prices Actual Values ³				French Wholesale Prices in Gold ⁴			
	I	II	III	IV	I	II	III	IV
1931	77 4	76 0	71 1	65 6				
1932	66 0	65 6	62 5	61 4				
1933	60 9	61 0	61 6	60 5				
1934	60 3	58 3	56 7	54 7				
1935	54 3	54 6	53 5	55 4				
1936	58 6	58 8	62 3	74 5				52 3
1937	82 0	83 7	93 6	94 2	57 3	56 5	52 0	48 2
1938	96 6	100 2	101 6	103 5	47 3	43 9	41 9	41 2
1939								

¹ Board of Trade Index converted to gold in the Reports of the Hungarian Institute for Economic Research

² Vierteljahrsshefte zur Konjunkturforschung

³ Statistisches Jahrbuch für das Deutsche Reich

⁴ Statistique générale de la France

BRITISH AND GERMAN EXPORT AND IMPORT PRICES¹

	(1929=100)					
	1929	1930	1931	1932	1933	1934
1 British Index of Export Prices ²	100	93.3	75.7	54.4	51.1	47.4
111.1	104.3	84.1	60.4	56.8	52.7	50.3
2 British Index of Import Prices	100	87.8	65.4	47.1	42.6	39.9
100	94.1	82.5	71.6	64.7	62.0	59.0
3 German Index of Export Prices	100	87.0	66.6	49.6	45.3	45.6
100	106.1	115.7	115.5	119.9	118.8	115.3
4 German Index of Import Prices	100	108.2	123.8	144.4	142.8	135.9
5 British Terms of Trade	100	90.2	98.1	118.5	113.9	117.6
6 German Terms of Trade	90	90.2	98.1	118.5	113.9	117.2
7 3 as per cent of 1, as adjusted						

¹ League of Nations Review of World Trade 1938 (Geneva, 1939) pp. 75-76, 78-79.
The figures in the lower line represent an 11.11 per cent upward adjustment of the original index in each case to correct for a 10 per cent overvaluation of sterling 1925-1931.

GERMANY'S FOREIGN TRADE BY QUARTERS¹

(Values in million Reichsmarks)

YEAR	I QUARTER			II QUARTER			III QUARTER			IV QUARTER			TOTAL Exports Trade	TOTAL Imports Trade	Balance of Trade
	Imports	Exports	Balance of Trade	Imports	Exports	Balance of Trade	Imports	Exports	Balance of Trade	Imports	Exports	Balance of Trade			
1929	3,354.9	3,054.7	-300.2	3,465.1	3,476.6	+11.5	3,338.8	3,487.3	+148.5	3,464.4	3,288.0	-176.4	13,446.8	13,483	+36
1930	3,171.0	3,222.0	+51.0	2,532.0	2,983.0	+450.0	2,440.0	2,923.0	+483.0	2,249.0	2,908.0	+659.0	10,393.0	12,036	+1643
1931	1,919.0	2,420.0	+501.0	1,885.0	2,348.0	+463.0	1,464.0	2,465.0	+1,001.0	1,459.0	2,366.0	+907.0	6,727.0	9,599	+2872
1932	1,261.7	1,605.4	+343.7	1,142.7	1,382.4	+239.7	1,057.9	1,302.6	+244.7	1,214.1	1,448.0	+233.9	4,667.0	5,739	+1072
1933	1,077.0	1,190.0	+113.0	1,011.0	1,188.0	+177.0	1,044.0	1,230.0	+186.0	1,072.0	1,263.0	+191.0	4,204.0	4,871	+667
1934	1,147.4	1,094.3	-53.1	1,152.8	991.9	-160.9	1,056.7	1,005.4	-51.3	1,094.1	1,075.3	-18.8	4,451.0	4,167	-284
1935	1,129.7	967.0	-162.7	1,008.7	995.0	-13.7	965.3	1,099.7	+134.4	1,055.0	1,208.0	+153.0	4,159.0	4,270	+111
1936	1,052.9	1,134.2	+81.3	1,058.4	1,107.7	+49.3	1,027.6	1,215.8	+188.2	1,079.2	1,310.5	+231.3	5,560	4,218.0	4,768
1937	1,092.7	1,285.2	+192.5	1,433.7	1,431.3	-2.4	1,443.4	1,565.8	+122.4	1,498.5	1,628.8	+130.3	5,468.0	5,911	+443
1938 ²	1,399.0	1,360.0	-39.0	1,316.0	1,253.0	-63.0	1,324.0	1,274.0	-50.0	1,427.0	1,376.0	-51.0	5,466.0	5,263	-203
1938 ³	1,399.0	1,360.0	-39.0	1,482.0	1,354.0	-128.0	1,476.0	1,375.0	-101.0	1,592.0	1,449.0	-143.0	5,949.0	5,538	-411
1939 ³	1,445.8	1,333.4	-112.4	1,285.5	1,459.9	+174.4									

¹ Wirtschaft und Statistik.

² Old Reich (without trade with Austria after April 1938).

³ Greater Germany. Figures for this year from Wirtschaft und Statistik, Vol. 19 No 9 p 332.

GERMANY'S FOREIGN TRADE IMPORTS¹ (Values in million Reichsmarks)

Value of all Imports	Food Supplies						Industrial Imports						
	Total Foods	Livestock	Groceries	Staple	Semn Luxuries	2 as Per Cent of 1	Raw Materials	7 as Per Cent of 1	Semi- Furnished Goods	9 as Per Cent of 1	Furnished Goods	11 as Per Cent of 1	
1	2	3	4	5	6	7	8	9	10	11	12		
13,446	8	5,380	6	149	7	4,487	6	743	3	40	0	1,764	8
10,393	1	4,229	7	118	3	3,676	4	635	0	40	7	1,410	9
6,727	1	2,783	2	54	9	2,289	8	438	5	41	4	966	4
4,666	5	2,132	7	34	3	1,775	9	322	5	45	7	557	8
4,203	6	1,629	7	30	9	1,302	4	296	4	38	8	1,367	6
4,451	0	1,543	2	33	3	1,213	2	296	7	34	5	791	5
4,158	7	1,435	2	45	2	1,110	4	279	6	34	5	747	5
4,217	9	1,499	4	96	3	1,113	9	289	2	35	5	750	0
5,468	4	2,045	1	107	5	1,614	9	322	7	37	4	980	3
5,449	3	2,110	8	113	0	1,650	9	346	9	38	7	1,367	6
13,511	9	5,522	9	150	2	4,669	9	702	8	40	9	2,308	3
12,039	0	5,013	8	122	0	4,190	4	701	4	41	6	1,995	5
10,156	4	4,245	9	71	1	3,572	2	602	6	41	8	1,700	4
9,464	6	4,212	1	71	2	3,600	0	540	9	44	5	1,417	8
9,311	9	3,601	9	69	0	2,967	4	565	5	38	7	1,069	4
9,809	4	3,676	8	71	2	2,953	3	642	3	37	5	1,768	8
8,956	2	3,180	6	85	1	2,467	4	628	1	34	5	1,695	8
8,610	0	3,194	0	166	9	2,328	1	645	4	37	0	1,640	3
10,089	3	4,133	6	168	2	3,253	0	712	4	41	0	1,786	7
11,008	6	4,539	4	176	5	3,253	9	744	3	486	5	1,786	7

¹ Statistisches Jahrbuch für das Deutsche Reich
² Old Reich from April 1938 and without trade with Austria

GERMANY'S FOREIGN TRADE EXPORTS¹ (Values in million Reichsmarks)

I Actual Values

Statistisches Jahrbuch für das Deutsche Reich
Old Reich from April 1938 on without trade with Austria

GERMANY'S TRADE WITH WESTERN EUROPE¹

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
Great Britain	6 4	6 1	6 7	5 5	5 7	4 6	6 2	5 6	5 6	5 2
Imports	865 3	639 0	453 3	258 5	238 4	205 7	256 2	263 7	308 6	282 7
Exports	1,305 5	1,218 9	1,133 6	446 0	405 6	382 9	374 9	405 8	432 2	350 9
Balance	+440 2	+579 9	+680 3	+187 5	+167 2	+177 2	+118 7	+142 1	+123 6	+68 2
France	4 8	5 0	5 1	4 1	4 4	4 0	3 7	2 9	2 6	143 7
Imports	641 9	518 7	341 6	189 9	184 0	176 9	154 2	98 9	155 7	143 7
Exports	6 9	9 5	8 7	8 4	8 1	6 8	5 9	5 9	5 9	4 1
Belgium	934 6	1,148 6	834 1	482 5	395 0	281 7	252 8	254 5	313 4	216 7
Imports	+292 7	+629 9	+492 5	+292 6	+211 0	+104 8	+98 6	+155 6	+157 7	73 0
Netherlands	3 3	3 1	3 3	3 1	3 3	3 6	3 0	3 3	3 6	3 6
Imports	447 2	324 6	222 1	146 3	138 8	161 0	126 2	138 6	197 6	194 4
Exports	4 5	5 0	4 8	5 7	5 7	5 3	4 7	4 4	4 4	4 8
Balance	608 8	600 6	463 5	301 5	278 1	235 9	201 8	211 5	287 8	227 4
Imports	+161 6	+276 0	+241 4	+155 2	+139 3	+74 9	+75 6	+72 9	+90 2	+33 0
Switzerland	5 2	5 4	5 7	5 9	5 5	5 9	4 7	4 0	3 9	3 6
Imports	700 9	560 8	383 6	273 1	232 0	264 1	196 1	168 5	215 8	197 9
Exports	1,355 2	1,205 8	954 6	632 8	612 8	481 8	404 2	395 5	463 0	447 8
Balance	+654 3	+645 0	+571 0	+359 7	+380 8	+217 7	+208 1	+227 0	+252 2	+249 2
Totals for Western Europe	22 1	22 1	23 2	20 6	20 9	20 7	20 3	18 4	17 7	16 9
Imports	2,973 1	2,298 6	1,565 2	959 9	875 7	923 8	847 1	775 9	971 4	921 3
Exports	4,831 2	4,801 5	3,927 4	2,274 5	2,043 9	1,677 6	1,490 6	1,492 8	1,752 4	1,450 0
Balance	1,858 1	2,502 9	2,362 2	1,314 6	1,168 2	753 8	643 5	716 9	761 0	528 7

¹ Statistisches Jahrbuch für das Deutsche Reich, 1931-1938.

² Wirtschaft und Statistik 1938, Vol. 19, No. 5 p. 177. The figures for 1938 do not include the new territories.

GERMANY'S TRADE WITH CREDITOR COUNTRIES¹
U S A, Sweden and Five Countries of Western Europe^a
(In percentage of total and in million Reichsmarks)

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
<i>Sweden</i>	<i>2.6</i>	<i>2.9</i>	<i>2.4</i>	<i>2.0</i>	<i>2.4</i>	<i>3.0</i>	<i>2.7</i>	<i>4.5</i>	<i>4.2</i>	<i>4.8</i>
Imports	350.3	304.1	158.1	95.1	102.6	133.8	152.9	191.7	231.9	261.7
Exports	35.5	44.1	44.4	44.0	39.9	48.8	48.8	48.8	47.7	51
Balance	+475.7	+494.2	+424.2	+228.1	+191.1	+198.3	+206.8	+230.4	+277.3	+267.3
	+125.4	+190.1	+266.1	+133.0	+88.5	+64.5	+53.9	+38.7	+45.4	+56
<i>U S A</i>	<i>1.83</i>	<i>1.02</i>	<i>1.18</i>	<i>1.27</i>	<i>1.15</i>	<i>8.4</i>	<i>5.8</i>	<i>5.5</i>	<i>5.2</i>	<i>7.4</i>
Imports	1,790.4	1,306.8	791.4	591.8	482.8	372.7	240.7	232.2	281.9	404.6
Exports	7.4	5.7	5.1	4.9	5.1	3.8	4.0	3.6	3.5	2.8
Balance	-991.1	-685.2	-487.5	-281.2	-245.9	-157.8	-169.5	-172.0	-208.8	-149.3
	-799.3	-621.6	-303.9	-310.6	-236.9	-214.9	-71.2	-60.2	-73.1	-255.3
Totals for <i>U S A</i> <i>and Sweden</i>	<i>15.9</i>	<i>15.5</i>	<i>14.2</i>	<i>14.7</i>	<i>13.9</i>	<i>11.4</i>	<i>9.5</i>	<i>10.0</i>	<i>9.6</i>	<i>12.2</i>
Imports	2,140.7	1,610.9	949.5	686.9	585.4	506.5	393.6	423.9	513.8	666.3
Exports	10.9	9.8	9.5	8.9	9.0	8.6	8.8	8.4	8.2	7.9
	1,466.8	1,179.4	911.7	509.3	437.0	356.1	376.3	402.4	486.1	416.6
Totals for Creditor Countries										
Imports	5,113.8	3,909.5	2,514.7	1,646.8	1,461.1	1,430.3	1,240.7	1,199.8	1,273	1,587.6
Exports	46.8	49.6	50.3	50.9	49.0	43.7	39.6	37.5	35.4	35.4

¹ Statistisches Jahrbuch für das Deutsche Reich, 1931-1938.

^a Five countries of Western Europe as given on the preceding page — Great Britain France Belgium Netherlands and Switzerland

1,866.6

GERMANY'S TRADE WITH EUROPE AND THE REST OF THE WORLD¹

Europe	Imports		Rest of the World		Total		Europe		Exports		Rest of the World		Total
	As Per Cent of Total	Million Rm.											
1929	7,066.5	52.6	6,380.3	47.4	13,446.8	9,924.1	73.7	3,558.5	26.3	13,482.7	12,035.6		
1930	5,825.0	56.0	4,568.2	44.0	10,393.2	9,377.2	77.9	2,658.4	22.1		9,598.6		
1931	3,763.5	55.9	2,963.5	44.1	6,727.0	7,777.8	81.0	1,820.8	19.0		5,739.1		
1932	2,499.4	53.6	2,167.1	46.4	4,666.5	4,646.5	81.0	1,092.6	19.0		4,871.4		
1933	2,281.4	54.3	1,922.2	45.7	4,203.6	3,801.1	78.0	1,070.3	22.0		4,166.9		
1934	2,560.5	57.5	1,890.6	42.5	4,451.1	3,188.3	76.5	978.6	23.5		4,269.7		
1935	2,554.0	61.6	1,594.7	38.4	4,158.7	3,124.5	73.2	1,145.2	26.8		4,768.2		
1936 ²	2,521.5	59.8	1,696.4	40.2	4,217.9	3,372.9	70.7	1,395.3	29.3		4,768.2		
1937	3,038.6	55.6	2,429.8	44.4	5,468.4	4,093.2	69.3	1,817.8	30.7		5,911.0		

BALANCE OF TRADE¹
(In million Reichsmarks)

	Europe	Rest of the World	Total
1929	+2,857.6	-2,821.8	+35.8
1930	+3,552.2	-1,909.8	+1,642.4
1931	+4,014.3	-1,142.7	+2,871.6
1932	+2,147.1	-1,074.5	+1,072.6
1933	+1,519.7	-851.9	+667.8
1934	+627.8	-912.0	-284.2
1935	+560.5	-449.5	+111.0
1936 ²	+851.4	-301.3	+550.1
1937	+1,054.6	-612.0	+442.6

¹ Statistisches Jahrbuch für das Deutsche Reich.² From 1936 on, Turkey (previously under Asia) is included under Europe.

GERMANY'S TRADE WITH SOME COUNTRIES OF LATIN AMERICA¹

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938 ^a
Argentina										
Imports	744.7	403.0	208.7	191.6	149.4	151.5	142.7	118.5	295.2	216.1
Exports	371.3	287.4	174.0	90.1	100.3	87.0	97.2	97.7	147.1	147.3
Balance	-373.4	-115.6	-34.7	-101.5	-49.1	-64.5	-45.5	-20.8	-148.1	-68.8
Bolivia										
Imports	8.6	8.1	7.6	2.5	1.6	3.1	6.3	7.4	11.0	8.3
Exports	12.1	9.3	3.8	2.1	2.8	2.9	2.4	4.2	5.6	9.4
Balance	+3.5	+1.2	-3.8	-0.4	+1.2	-0.2	-3.9	-3.2	-5.4	+1.1
Brazil										
Imports	214.9	155.9	123.1	81.4	68.7	77.2	178.9	131.4	186.2	214.3
Exports	210.2	120.7	66.7	48.4	76.5	74.5	118.6	133.4	177.0	161.4
Balance	-4.7	-35.2	-56.4	-33.0	+7.8	-2.7	-58.3	+2.0	-9.2	-53.1
Chile										
Imports	121.7	56.4	41.8	23.5	20.0	36.4	52.3	58.8	81.2	90.7
Exports	99.5	100.1	39.4	8.3	8.1	11.8	32.1	49.4	56.4	60.5
Balance	-22.2	+43.7	-2.4	-15.2	-11.9	-24.6	-20.2	-9.4	-24.8	-30.2

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Colombia	27 6	19 8	12 7	9 0	11 2	13 4	20 6	41 5	45 0	46 6
Imports	60 8	27 0	17 7	14 3	20 4	17 4	27 7	45 3	33 1	41 2
Exports	+33 2	+7 2	+5 0	+5 3	+9 2	+4 0	+7 1	+3 8	-11 9	-5 4
Balance										
Mexico										
Imports	95 4	61 1	40 6	23 8	20 1	24 1	38 1	56 4	64 6	62 2
Exports	59 0	57 0	28 4	25 7	27 1	25 8	34 0	51 1	65 7	45 8
Balance	-36 1	-4 1	-12 2	+1 9	+7 0	+1 2	-4 1	-5 3	+1 1	-16 4
Peru										
Imports	14 9	24 1	20 3	10 4	17 6	19 4	35 6	34 0	49 0	38 7
Exports	25 6	18 8	7 2	5 7	6 0	7 8	17 6	29 0	33 2	30 9
Balance	+10 7	-5 3	-13 1	-4 7	-11 6	-11 6	-18 0	-5 0	-15 8	-7 8
Total Imports	1,227 8	728 4	459 8	342 2	288 6	325 1	472 5	448 0	732 2	677 0
Total Exports	838 5	620 3	357 2	194 6	241 2	226 7	329 6	410 1	518 1	496 4
Total Balance	-389 3	-108 1	-117 6	-147 6	-47 4	-98 4	-142 9	-37 9	-214 1	-180 6

¹ Statistisches Jahrbuch für das Deutsche Reich, und Wirtschaft und Statistik.

Old Reich

GERMANY, AUSTRIA, AND UNITED KINGDOM IN THE TRADE OF SOUTHEASTERN EUROPE¹
 PERCENTAGE SHARES OF INDIVIDUAL COUNTRIES

	(I = Imports, E = Exports)						1937											
	1929		1930		1931		1932		1933		1934		1935		1936		1937	
	I	E	I	E	I	E	I	E	I	E	I	E	I	E	I	E	I	E
Bulgaria																		
Germany	22.2	29.9	23.2	26.2	23.3	29.5	25.9	26.0	38.2	36.0	40.6	42.8	53.5	48.0	61.0	47.6	54.8	43.1
Austria	7.6	12.5	6.8	7.7	7.2	16.7	6.0	15.0	6.2	9.7	4.8	5.3	6.4	4.6	5.7	3.0	3.4	4.0
United Kingdom	8.9	1.6	8.2	2.1	13.2	1.0	10.3	2.5	6.9	1.8	6.4	2.1	4.7	4.4	4.6	11.6	4.7	13.8
Greece																		
Germany	9.4	23.2	10.4	23.3	12.2	14.0	9.6	14.5	10.2	17.9	14.7	22.5	18.7	29.7	22.4	36.4	27.2	31.0
Austria	1.1	2.5	1.2	2.8	1.5	5.6	2.2	4.2	1.3	1.8	1.8	2.1	2.0	1.4	2.1	2.3	2.5	1.7
United Kingdom	12.7	11.7	13.0	12.5	13.2	15.0	13.7	23.4	14.4	18.9	16.7	17.4	15.5	12.6	16.1	12.2	11.0	9.6
Hungary																		
Germany	20.0	11.7	21.3	10.3	24.4	12.7	22.4	14.8	19.7	11.2	18.2	22.1	22.6	23.0	26.0	22.8	26.2	24.1
Austria	13.2	30.4	11.5	28.1	12.4	29.8	15.9	31.1	20.0	27.0	23.7	24.5	19.1	18.9	16.6	17.2	18.0	16.9
United Kingdom	2.8	3.6	4.2	5.6	3.9	9.8	4.5	6.7	4.4	8.0	5.2	7.8	5.1	8.1	5.1	8.7	5.3	7.1
Jugoslavia																		
Germany	15.6	8.5	17.6	11.7	19.3	11.3	17.7	11.3	13.2	13.9	13.9	15.4	16.2	18.6	26.7	23.7	32.4	21.7
Austria	17.4	15.6	16.8	17.7	15.2	15.2	13.4	22.1	16.1	21.7	12.4	16.4	11.9	14.3	10.3	14.6	10.3	13.5
United Kingdom	5.6	1.3	5.9	1.5	6.6	2.0	7.4	2.1	9.7	2.7	9.3	4.7	10.1	5.3	8.5	9.9	7.8	7.4
Romania																		
Germany	24.1	27.6	25.1	18.8	29.1	11.4	23.7	12.3	18.6	10.6	15.5	16.6	23.8	16.7	36.1	17.8	28.9	19.2
Austria	12.5	9.4	11.6	9.1	8.8	10.7	4.9	6.4	9.2	6.6	9.9	9.1	10.8	12.6	13.4	8.6	8.5	6.8
United Kingdom	7.3	6.3	8.1	11.3	8.3	10.1	10.8	14.0	14.9	15.4	16.3	10.0	9.8	9.6	7.4	14.4	9.4	8.8
Turkey																		
Germany	15.3	13.3	18.6	13.1	21.3	10.7	23.3	13.5	25.5	18.9	33.8	37.4	40.0	40.9	45.1	51.0	42.1	36.5
Austria	2.2	0.5	2.2	0.9	2.2	0.9	2.0	1.6	1.9	1.0	2.4	1.6	3.3	1.9	2.8	1.2	1.6	2.0
United Kingdom	12.2	9.6	11.2	8.9	11.4	8.6	12.3	9.9	13.5	8.9	9.9	5.8	9.8	5.4	6.6	5.4	6.2	7.1

¹ League of Nations International Trade Statistics (Geneva 1938)

GERMAN TRADE WITH INDUSTRIAL AND OTHER COUNTRIES¹

(Percentages of total imports and exports)

	Imports from Industrial Countries	Rest of the World	Exports to Industrial Countries	Rest of the World
1928	40.9	59.1	46.2	53.8
1929	38.9	61.1	47.6	52.4
1930	38.4	61.6	48.6	51.4
1931	39.1	60.9	48.4	51.6
1932	36.1	63.9	45.9	54.1
1933	35.4	64.6	46.4	53.6
1934	33.0	67.0	46.4	53.6
1935	31.1	68.9	43.5	56.5
1936	29.9	70.1	38.4	61.6
1937	27.8	72.2	36.9	63.1

¹ Austria Belgium Czechoslovakia France Great Britain Italy (with colonies) Japan Luxembourg U S A Switzerland² V z K Vol 13 No 3 N S p 316BRITISH AND GERMAN IMPORTS AND EXPORTS¹
(In millions of old gold dollars)

	1929	1930	1931	1932	1933	1934	1935	1936
1 British Imports	4,658	3,585	2,276	2,073	2,048	2,039	2,313	2,787
2 British Exports	3,549	2,778	1,772	1,279	1,213	1,190	1,239	1,523
3 German Imports	3,203	2,476	1,802	1,112	996	1,046	991	1,005
4 German Exports	3,212	2,867	2,286	1,367	1,155	979	1,017	1,136
3 as per cent of 1	63.5	53.2	44.6	48.8	48.1	51.07	48.6	46.6
4 as per cent of 2	90.5	103.9	129.0	106.8	95.2	82.3	82.1	87.7
								92.3

¹ League of Nations Review of World Trade

A Decade of German Imports of Cotton

Quantity and Value by Countries¹

	A Quantity in metric tons									
	1928	1929	1930	1931	1932	1933	1934	1935 ^a	1936	1937
Egypt	19,134	24,210	24,763	29,740	33,715	39,838	44,930	39,607	29,610	40,850
British India	48,233	57,300	55,920	37,552	23,521	38,378	37,599	32,182	38,840	36,360
U S A	337,682	336,165	296,131	256,594	317,371	341,232	220,173	106,226	116,850	118,850
Turkey			2,429	1,460	2,305	624	5,809	15,405	16,240	8,420
Brazil	754	726	3,838	2,524	2,377	8,299	82,778	38,120	70,090	
Argentina	2,237	3,447	3,415	2,312	4,793	5,280	5,673	14,503	9,640	5,870
Peru	2,647	2,172	6,003	10,259	8,473	9,710	11,329	25,296	18,800	18,580
Mexico	899	2,344	72				311	3,534	8,870	7,860
Total	462,983	476,802	433,128	379,809	424,724	473,333	399,455	397,439	325,030	349,650
	B Value in million Reichsmarks									
Egypt	47.97	58.50	46.00	37.63	31.88	36.53	39.19	39.53	32.7	43.1
British India	71.36	76.41	55.26	26.13	13.74	20.44	17.90	20.59	25.9	23.6
U S A	619.03	618.54	427.62	235.78	219.72	233.4	146.09	71.13	77.8	78.4
Turkey			3.21	1.29	1.75	47	4.91	15.49	14.7	8.3
Brazil	1.38	1.27	5.92	2.50	10		7.24	92.08	38.4	65.0
Argentina	4.56	6.81	5.21	2.17	3.23	3.97	4.17	13.71	8.7	5.7
Peru	5.19	5.03	9.43	11.03	6.87	7.70	9.14	25.89	20.2	20.8
Mexico	1.69	4.85	10				21	3.92	8.0	7.1
Total	795.03	814.71	580.53	336.64	291.27	306.99	260.24	329.72	257.7	275.1

¹ Statistisches Jahrbuch für das Deutsche Reich.

A DECADE OF GERMAN IMPORTS OF COPPER
Quantity and Value by Countries¹

	<i>A</i>	<i>Quantity in metric tons</i>	<i>B</i>	<i>Value in million Reichsmarks</i>
U S A	181,175	1929	1930	1931
Chile	34,987	110,421	64,982	57,462
Spain	10,031	39,763	23,739	20,315
Yugoslavia	6,741	8,555	7,256	5,829
U K	8,448	13,309	15,940	15,115
Belgian Congo	2,689	4,359	4,553	4,610
British South Africa	938	1,280	8,744	21,917
Rhodesia			1,264	907
Total	296,375	262,071	211,216	192,104
				175,161
				207,141
				228,623
				216,031
				195,120
				262,510
U S A	230,60	173,20	78,94	46,99
Chile	48,45	65,98	29,38	16,83
Spain	13,20	13,25	8,92	4,05
Yugoslavia	9,10	13,38	20,99	12,97
U K	8,78	17,12	4,44	2,73
Belgian Congo	3,70	7,41	10,24	18,67
British South Africa	1,25	2,12	1,42	0,72
Rhodesia				
Total	376,36	403,92	250,76	156,69
				95,64
				102,25
				96,77
				80,70
				87,70
				174,6

¹ Statistisches Jahrbuch für das Deutsche Reich

GERMAN IMPORTS, EXPORTS, TRADES, AND BALANCE OF TRADE
(In billion Reichsmarks)

	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
1 Imports, actual prices ¹	13 44	10 39	6 73	4 67	4 20	4 45	4 16	4 22	5 47	5 46 ²
2 Exports, actual prices ¹	13 48	12 03	9 60	5 74	4 87	4 17	4 27	4 77	5 91	5 26 ²
3 Balance of Trade, actual prices	+0 04	+1 64	+2 87	+1 07	+0 67	-0 28	+0 11	+0 55	+0 44	-0 20
4 Imports at prices of 1929	13 44	11 97	10 12	9 42	9 27	9 76	8 91	8 57	10 04	10 70
5 Exports at prices of 1929	13 48	12 77	11 63	8 01	7 52	6 72	8 23	7 98	9 23	7 75
6 Balance of Trade at prices of 1929	+0 04	+0 80	+1 51	-1 41	-1 74	-3 05	-1 68	-0 59	-0 81	-2 95
7 Import Price Index ³	100	87 0	66 6	49 6	45 3	45 6	46 7	49 2	54 4	52 1
8 Export Price Index ³	100	94 1	82 5	71 6	64 7	62 0	59 0	60 0	64 0	67 1
9 Terms of Trade ⁴	100	108 2	123 8	144 4	142 8	135 9	126 6	122 0	117 6	128 8
10 Difference Actual balance minus balance at prices 1929 (3-6)	0	0 84	1 36	2 48	2 41	2 77	1 79	1 14	1 25	2 75

$\frac{eP}{eP_1}$
 $\frac{1/P_2}{1/P_1}$

¹ Statistisches Jahrbuch für das Deutsche Reich 1938 pp 256-257 Figures for 1938 do not include Austria but after October 1 do include Sudetenland

² League of Nations Review of World Trade 1938 (Geneva 1939) pp 75-76

⁴ Computed after the formula

GERMANY'S SHARE OF WORLD TRADE¹
(Values in million of old gold dollars)

1 World Imports	2 World Exports	3 World Total	4 World Trade Index	5 German Imports	6 German Exports	7 as Per Cent of 1	8 as Per Cent of 2	9 German Imports Index	10 German Exports Index
1929 35,595	33,024	68,619	100	3,203 1	3,211 6	9 00	9 72	100	100
1930 29,093	26,492	55,585	81 0	2,367 0	2,867 0	8 20	10 82	77 3	89 2
1931 20,847	18,922	39,769	57 9	1,602 0	2,286 0	7 70	12 09	50 0	71 2
1932 13,968	12,887	26,855	39 1	1,112 0	1,367 0	7 96	10 60	34 7	42 3
1933 12,485	11,694	24,179	35 2	1,986 0	1,155 0	7 98	9 88	31 1	36 0
1934 11,983	11,305	23,286	34 0	1,045 5	991 0	8 72	8 76	32 6	30 8
1935 12,093	11,457	23,550	34 3	990 6	1,017 0	8 20	8 88	30 9	31 7
1936 13,145	12,577	25,722	37 5	1,004 7	1,137 0	7 64	9 03	31 4	35 4
1937	16,222	15,369	31,591	46 0	1,299 4	1,406 0	8 01	9 15	40 6

¹ League of Nations Review of World Trade

GERMAN FOREIGN TRADE UNDER PAYMENT AGREEMENTS IN 1937 AND 1938¹
(Imports and exports in million Reichsmarks)

Country	Date of Agreement	1937			1938		
		Imports	Exports	Balance	Imports	Exports	Balance
Belgium, Luxembourg	July 27, 1935	197.6	287.7	+90.1	194.4	227.4	+33.0
France	July 7, 1937	155.7	313.3	+157.6	143.7	216.7	+73.0
Great Britain	November 1, 1934	308.6	432.2	+123.4	282.7	350.9	+68.2
Ireland	January 28, 1935	9.7	14.1	+4.4	11.3	29.1	+17.8
Canada	October 22, 1936	48.7	33.4	-15.3	72.8	25.4	-47.4
Japan	May 27, 1937	25.7	117.3	+91.6	25.0	93.0	+68.0
New Zealand	September 30, 1937	100.0	73	-27	8.7	8.0	-0.7
Syria, Liberia	January 30, 1937	1.0	5.6	+4.6	1.7	5.8	+4.1
Total under agreements entered before 1938	757.0	1,210.9	+453.7	740.3	956.3	+216.0	
Percentage of total trade		14.1	20.9		13.5	18.2	
South Africa	September 19, 1938				76.6	81.9	+5.3
Manchukuo	September 14, 1938				76.9	27.2	-49.7
Total under agreements to end of 1938					893.8	1,065.4	
Percentage of total trade					16.3	20.2	

¹ Wirtschaft und Statistik, 1939, Vol. 19, No. 5, p. 177.

² Without Austrian trade but including Sudetenland after October 1, 1938.

A DECADE OF GERMAN IMPORTS OF WOOL
Quantity and Value by Countries¹
A Quantity in metric tons

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
Belgium	9,543	9,370	8,715	11,198	8,884	9,177	7,276	5,830	3,580	3,340
France	10,182	9,887	8,490	10,632	12,536	13,385	8,430	6,639	3,790	8,360
U K	15,104	14,073	10,073	9,725	10,670	13,771	10,434	29,169	6,860	5,960
U S S R	1,412	1,54	2,578	5,823	5,173	3,666	4,975	2,289		
C S R	3,185	3,566	2,606	2,642	1,635	1,773	3,152	780		
British South Africa	30,068	30,601	27,079	24,256	29,747	25,253	20,576	33,516	19,820	22,380
Argentina	40,111	40,187	30,960	23,821	18,564	20,786	21,579	28,129	16,620	9,900
Australia	65,410	63,139	66,718	54,605	60,988	63,103	45,148	16,698	17,090	21,450
New Zealand	6,159	6,531	6,032	9,610	11,702	21,301	19,924	2,473	3,450	4,020
Uruguay	5,861	6,087	9,375	16,257	10,620	11,710	10,470	7,993	5,510	4,370
Chile	1,183	1,054	411	1,389	1,210	1,098	3,300	7,869	7,260	9,450
Peru	314	112						414	1,761	2,740
Brazil	1,443	1,891	2,659	2,511	1,075	1,726	1,679	5,250	6,940	3,820
Spain	792	471	337					544	683	5,510
Turkey								6,070	3,981	4,680
China	693	626	475					1,283	2,282	4,880
Total	207,531	204,632	186,816	181,678	180,050	197,852	180,143	156,284	125,410	128,170

¹ Statistisches Jahrbuch für das Deutsche Reich

A DECADE OF GERMAN IMPORTS OF WOOL
 Quantity and Value by Countries¹—(Continued)
 B Value in million Recksmarks

	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937
Belgium	49.54	56.16	36.83	33.74	22.05	23.33	23.89	17.90	12.7	15.3
France	55.25	49.74	33.40	31.22	28.08	32.03	21.46	17.53	12.1	30.2
U K	65.68	60.80	31.62	22.16	19.69	22.50	21.84	47.25	17.5	16.3
U S S R	2.39	2.51	4.53	7.21	4.25	3.07	4.48	3.38		
C S R	9.81	9.45	6.15	4.39	1.69	1.64	4.76	1.37		
British South Africa	112.14	109.61	61.52	38.34	30.62	26.55	34.79	39.25	28.6	41.5
Argentina	126.85	121.94	62.49	30.77	18.07	19.52	29.51	31.71	24.3	17.6
Australia	249.34	237.23	162.85	96.23	77.39	89.34	92.65	28.46	32.7	46.5
New Zealand	16.75	21.03	13.52	16.30	12.01	22.53	32.82	31.10	4.9	8.4
Uruguay	21.20	21.38	18.82	22.28	11.17	12.90	17.83	10.72	9.7	10.1
Chile	4.76	3.42	0.85	1.97	1.33	1.32	5.43	12.00	15.7	24.6
Peru	1.18	0.41					0.59	3.19	6.5	8.6
Brazil	5.49	6.58	4.91	3.20	1.18	1.50	2.43	7.73	13.1	9.4
Spain	2.80	1.50	0.84				0.74	1.74	2.2	9.2
Turkey							0.25	8.69	6.27	8.8
China	1.92	1.76	1.34				0.53	1.56	2.92	9.9
Total	764.17	739.45	459.50	321.82	236.38	266.19	322.63	248.06	229.4	285.2

¹ Statistisches Jahrbuch für das Deutsche Reich

BLOCKED MARK QUOTATIONS
As Percentages of Gold Parity¹

	Registered Marks	Travel Marks	Credit Marks	Security Marks
<i>1934</i>				
I	81 4		82 0	64 3
II	75 7		75 0	59 5
III	72 5		72 0	58 0
IV	66 4		56 0	47 0
V	65 7		49 8	44 5
VI	58 3		45 0	30 8
VII	63 8		49 0	38 5
VIII	58 5		39 5	34 3
IX	58 7		42 8	34 3
X	52 0		43 5	32 0
XI	53 5	61 7	43 6	33 5
XII	60 6	67 9	48 4	39 2
<i>1935</i>				
I	62 2	69 5	51 6	40 5
II	65 1	71 3	48 6	39 4
III	60 7	69 8	44 8	33 9
IV	57 7	68 1	40 0	32 4
V	53 8	62 9	33 4	28 7
VI	55 7	64 8	33 6	24 9
VII	57 5	64 8	34 3	26 3
VIII	57 4	66 8	32 3	24 6
IX	52 1	65 5	29 0	21 9
X	49 2	62 6	31 0	20 5
XI	51 1	59 0	33 2	21 8
XII	53 0	61 9	36 1	24 0
<i>1936</i>				
I	52 7	62 4	37 4	24 8
II	55 3	62 4	38 1	25 6
III	53 4	62 4	33 9	24 9
IV	53 3	61 0	30 2	26 3
V	53 5	62 4	30 1	24 3
VI	52 6	62 4	28 9	23 7
VII	53 6	62 7	28 1	24 5
VIII	54 1	64 5	25 6	24 6
IX	54 3	62 8	23 2	22 7
X	57 6	58 2	20 1	18 0
XI	51 7	57 0	21 2	17 4
XII	49 3	55 3	22 2	20 3

¹ League of Nations Statistical Yearbooks 1935-1939 (Geneva 1935-1939) The quotations on registered Marks are taken from the London market others from Zurich Quotations are monthly averages except for the first ten months of 1934 for which mid month values are given

BLOCKED MARK QUOTATIONS — (*Continued*)

	Registered Marks	Travel Marks	Credit Marks	Security Marks
<i>1937</i>				
I	46 0	51 9	25 4	22 9
II	47 9	53 3	24 6	23 5
III	48 5	59 7	25 8	25 2
IV	48 1	59 4	25 7	24 6
V	48 6	59 7	23 8	22 4
VI	51 5	62 2	22 5	22 1
VII	55 9	66 1	21 7	20 9
VIII	56 9	67 6	21 5	20 5
IX	54 9	65 4	21 0	20 9
X	51 6	63 5	19 2	19 1
XI	51 5	62 1	19 3	19 2
XII	53 0	63 1	18 1	18 0
<i>1938</i>				
I	53 3	62 5	15 0	14 5
II	51 2	62 1	13 3	11 4
III	49 6	60 6	17 9	12 6
IV	48 8	60 4	16 9	14 6
V	48 5	60 0	13 9	13 5
VI	46 7	58 3	12 1	11 6
VII	45 9	56 7	11 8	10 5
VIII	44 5	56 7	12 1	9 3
IX	37 8	55 0	10 9	8 8
X	42 5	54 2	12 3	11 6
XI	45 0	56 0	12 7	11 4
XII	44 1	58 9	12 3	11 4
				Commercial Marks
<i>1939</i>				
I	41 2	58 3	10 4	
II	37 5	53 9	9 7	
III	40 5	55 9	10 8	
IV	36 9	54 7	10 1	

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